

## The impact of the financial crisis on European defence

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**DIRECTORATE-GENERAL FOR EXTERNAL POLICIES**  
**POLICY DEPARTMENT**



**THE IMPACT OF THE  
FINANCIAL CRISIS ON  
EUROPEAN DEFENCE**

**SEDE**

**DIRECTORATE-GENERAL FOR EXTERNAL POLICIES OF THE UNION**

**DIRECTORATE B**

**POLICY DEPARTMENT**

**STUDY**

**THE IMPACT OF THE FINANCIAL CRISIS ON EUROPEAN DEFENCE**

**Abstract**

The financial crisis may pose a risk as well as offer an opportunity for the European defence sector: on the one hand, it sounds plausible that shrinking budgets increase the pressure on member states to cooperate and thus overcome the EU's problems related to capability development and restructuring of the defence industries and markets. On the other hand, national prerogatives still dominate despite a decade of rhetoric and initiatives for more cooperation and less state in EU defence. If this national focus continues to dominate under current financial circumstances, EU member states run the risk to implement cuts in their Armed Forces in an uncoordinated way. As a result, member states might end up with potentially even bigger capability gaps than they have today and hence even less opportunities to implement the Common Security and Defence Policy (CSDP). This study provides a comprehensive and detailed overview on the ongoing impact of the financial crisis on EU Member States defence spending. In addition, it examines the potential of overcoming the need to cut defence spending by greater cooperation in the framework of the European Union and by drawing upon the innovations in the Lisbon Treaty. The study highlights the need to address the challenges of the economic crisis, a growing number of initiatives by various EU countries as well as the opportunities the Lisbon Treaty offers for pursuing an effective defence sector strategy that goes beyond the current incremental approach. The study has been requested to provide Members of the European Parliament, broader defence policy community and European public a first comprehensive overview of the impact of the financial crisis on European defence and at the EU level, as well as its wider impact on the future of the Common Security and Defence Policy (CSDP). It includes recommendations to be developed by the European Parliament and decision makers at the national and EU level in order to address the economic crisis whilst ensuring Europe retains defence capabilities to respond to future security challenges.

This study was requested by the European Parliament's Subcommittee on Security and Defence.

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## ABBREVIATIONS

AMV	Armoured Modular Vehicle
BG	Battlegroup
C2	Command and Control
C3	Command, Control and Communications (US); Consultation, Command and Control (NATO)
C4ISR	Command, Control, Communications, Computers, Intelligence, Surveillance and Reconnaissance
CBRN	Chemical, Biological, Radiological and Nuclear
CFSP	Common Foreign and Security Policy
CIACI	Interministerial Committee to support Civil and Military Export
CIMIC	Civil-Military Cooperation
COTS	Civilian Off The Shelf
CS	Counter-Strike
CSAR	Combat Search And Rescue
CSDP	Common Security and Defence Policy
CSS	Combat Service Support
DCNS	Direction des Constructions Navales Services
DGA	Délégation Générale pour l'Armement
DIRCM	Laser-based infrared countermeasures system
DIS	Defence Industrial Strategy
DPG	Defence Policy Guidelines
EADS	European Aeronautic Defence and Space Company
EDA	European Defence Agency
EOD	Explosive Ordnance Disposal
ESS	European Security Strategy
EU	European Union
EUBG	EU-Battlegroup(s)
EUFOR	European Force
EUSEC	European Communications Security and Evaluation Agency of the Military Committee
EUTM	EU Training Mission
FREMM	Frégate Multi-Mission



GAF	German Armed Forces
GDP	Gross Domestic Product
GNI	Gross National Income
HHG	Helsinki Headline Goal
HG 2010	Headline Goal 2010
IED	Improvised Explosive Device
IMF	International Monetary Fund
ISAF	International Security Assistance Force
ISR	Intelligence, Surveillance and Reconnaissance
ISTAR	Intelligence, Surveillance, Target Acquisition and Reconnaissance
JSF	Joint Strike Fighter
KFOR	Kosovo Forces
LoA	Level of Ambition
MALE UAV	Medium-Altitude Long Endurance UAVs
MBDA	Matra BAE Dynamics Alenia
MBU	Modular Battle Units
MEADS	Medium Extended Air Defence System
MED	Ministry for Economic Development
MINURCAT	UN Mission in the Central African Republic and Chad
MoD	Ministry of Defence
MONUC	Mission de l'Organisation des Nations Unies en République Démocratique du Congo (UN Observer Mission in the Democratic Republic of the Congo)
MOTS	Military Off The Shelf
MPL	Military Programming Law
MRAP	Mine-Resistant Ambush-Protected Vehicle
NADMP	National Air Defence Modernisation Plan
NATO	North Atlantic Treaty Organisation
NBC	Nuclear, Biological, Chemical
NORDEFCO	Nordic Defence Cooperation
NRF	Nato Response Force
NSS	National Security Strategy
OHB	Orbitale Hochttechnologie Bremen

OMLT	Operational Mentor and Liaison Team
OSCE	Organisation for Security and Cooperation in Europe
PfP	Partnership for Peace
PSCoop	Permanent Structured Cooperation
R&D	Research and Development
R&T	Research and Technology
SAR	Search And Rescue
SDR	Strategic Defence Review
SDSR	Strategic Defence and Security Review
SEDM	South-Eastern Europe Defence Ministerial Process
SEEBRIG	South Eastern Europe Brigade
STOVL	short take-off vertical landing
TFEU	Treaty on the functioning of the European Union
UAV	Unmanned Aerial Vehicle
UN	United Nations
UNDOF	UN Disengagement Observer Force
UNFICYP	UN Peace-Keeping Force in Cyprus
UNIFIL	United Nations Interim Force in Lebanon
UNMIS	UN Mission in Sudan
UNTSO	UN Truce Supervision Organization
WEAG	Western European Armaments Group
WEAO	Western European Armaments Organisation
WMD	Weapons of Mass Destruction

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## EXECUTIVE SUMMARY

### **EU Capability generation: thee problems –still not overcome**

EU Member States are unable to guarantee their security by acting unilaterally in the face of threats in the neighbourhood and further afield. This insight is clearly stated in the 2003 European Security Strategy and is the spirit of cooperation under the European Security and Defence Policy (ESDP) launched in 1999. EU Member states have committed themselves to political aims and military headline goals to become more active and coherent on defence matters. In particular, their objective is to cooperate on overcoming existing capability gaps and to investing in future capabilities.

In 2009 the Lisbon Treaty came into force and EU Member States confirmed their intention to cooperate on defence by enhancing ESDP under the Common Security and Defence Policy (CSDP). Whilst this commitment and the launch of some 24 missions and operations over the last decade is an important sign of political will, the record on overcoming capability short falls has been much less impressive. Until today European forces fight together in various theatres around the world, but they are still largely organised and equipped separately. At the EU level virtually no joint funding for capabilities or equipment exists. Joint spending in the area of armaments is more the exception than the rule: amounting only to about 20%.

This lack of resources at the EU level is contrasted by inefficient national level practices whereby the 27 EU defence ministers and their bureaucratic apparatuses currently spend over 200 billion euros a year and manage approx. 1.7 million soldiers but cannot make 10 percent of these forces available for active deployment. The inability for EU Member States to better coordinate their defence policies and budgetary cycles results in missed opportunities to make up growing capability shortfalls and their achievement of international military commitments including within the framework of CSDP.

Capability development in Europe, i.e. the phase of capability development (planning, set up, organisation and routine management of armed forces) and the preceding armaments phase (generating and maintaining equipment) has the following major problems:

In the phase of capability development the EU has developed a plethora of initiatives, bodies and agencies but with limited record of delivery on capabilities. The are headline goals, concepts, plans and mechanisms that can only provide a rudimentary answer to the question “What forces for what operations”. The EU institutions have worked upon creating a shared perception of the problems and needs. Member states have certainly engaged in developing collective military capabilities at the EU level. But beyond EU-Battlegroups, an EU Headquarters and strategic lift which offer at least some palpable output, they still recognise severe capability shortfalls. This is predominantly a question of political will where EU Member States fail to commit themselves beyond the level that supports individual national capability needs. But in addition the EU- level actors, i.e. in the Council, the Commission and the European External Action Service (EEAS), remain disjointed in the effort to create a system that generates a “bigger bang for the Euro”.

The armaments phase is less characterized by the strained relationship among traditional national industrial and technology policies on the one hand and internationalized market and production structures on the other. In addition, article 346 (TFEU) and the principle of juste retour cooperation hinders EU level cooperation and encourages initiatives outside the EU- framework. The result is a complex pattern of structural cooperation that is characterized by an obstructing diversity of 27 EU member state policies of defence, market, technology and industry. EU taxpayers carry the burden i.a. of duplication of defence industrial production sites. As these suppliers offer more than the EU market can absorb, industries are forced to export. In addition, protected domestic markets with a limited numbers of suppliers do not contribute to the competitiveness of producers and therefore result in more costly equipment.

The most serious problem however is the missing link between the EU armaments and the capability development phases. They are both institutionally and conceptually fragmented and there are virtually no resources available for both, besides those controlled by the EU Member States. As a consequence national and multinational equipment programmes always arrive too late, more expensive than envisaged and under-perform. The link between the armaments phase and the capability development phase is of paramount importance for effective and efficient capability generation as a whole. In particular, coherence in the generation of capabilities creates important advantages and even essential conditions for defence cooperation i.e. what you develop and build jointly, you can operate and maintain jointly.

Several innovations during the last decade have engaged with these problems and in particular the poorly developed link between the armaments and the capability development domains. The European Defence Agency (EDA) represents the missing link between the capability development and the armaments phases. It can engage with the whole spectrum of capability relevant issues: research & technology, markets & Industry, capability development and armaments. However, the success of the EDA is limited due to the limited use by the Member States and especially Ministries of Defence (MoDs) of their Agency.

The EU Commission has succeeded in establishing a role at the intersection of defence vis-à-vis issues of internal market, industrial policies and research. It may be the only actor that can effectively establish a framework for competitiveness through defence specific legislation and policies. A litmus test for the Commissions future role will be the implementation of the "defence package", a set of two directives that offer a harmonized legal framework for procurement and the transfer of military items. The package not only engages with the Member States dominance in the armaments domain but it could also lead to a profound change in procurement practices.

In addition, the Lisbon Treaty introduces an innovative package that has real potential to improve the coherence of the overall institutional framework and in particular the area of EU-capability generation. The protocol on *Permanent Structured Cooperation (PSCoop)* could in a long-term perspective bolster the link between the armaments framework and the capability development phase as well as enhance the role of the EDA. However, competing political visions and ambiguous strategic objectives complicate the road to implementing the innovations in the Lisbon Treaty. In addition, the current financial crisis has weakened Member States confidence, so far, to table tangible proposals on how to implement PSCoop.

It is still the political will of the member states that paves the way towards a greater role for the EU in achieving the desperately needed coherence in capability generation. For the EU's Common Security and Defence Policy (CSDP) this raises the question of how long member states will be willing and able to fund the gap between the political rhetoric of joint action and their unilateral practices. This question is particularly salient in the light of ongoing foreign operations and rising personnel costs which are squeezing the already diminishing resources for defence transformation needs, i.e. research, development and procurement. Moreover the dream of national security and independence of supply has not only become quite unaffordable, but has also been taken over by reality. International dependencies in production, in supplies and in services are increasingly the norm. Today, no single European state retains the ability to produce and develop the entire range of capabilities needed by its armed forces on its own. Most of the time the state does not even own the industry required to produce these capabilities. Hence, the question is no longer which defence industrial, technological and military capabilities should be preserved by the nation-state, but which ones are required by Europe and who provides them.

## Financial crisis and Member State reactions

In this context, the financial crisis has put public budgets throughout the European Union under severe pressure. There has been a swift and massive reduction in the available financial resources which has led to equally swift and substantial budgetary cuts. At the same time the crisis has led to the withdrawal of those resources that enabled Ministries to conceal inefficiencies in the defence sector. This situation will continue for a long time. Hence EU member states have to seek resource-saving solutions and increase the incentives to examine the efficiency potential of European procurement cooperation.

The financial crisis creates a turning point for the generation of capabilities for all EU Member States – albeit with an unclear direction so far. Member states have to adapt the affected policy areas to these new realities. This is even true for those few states whose defence budget is not affected by the financial crisis. As contributions to security and defence of individual members decrease, all EU countries are affected. This may be through decreasing guarantees for their territorial defence or through increasing demands for troop contributions to crisis management for those who remain capable to deliver. While this may initially create free riding, losing the ability to contribute to EU security will soon be felt as the inability to shape policies.

However, there is a considerable risk that a loss of the capacity to act in the military realm is only perceived after significant cuts into EU capabilities and loss of industrial and technological base have already taken place.

The initial response of member states to the financial crisis has been to evoke the traditional pattern of national prerogatives in defence matters rather than a security guided rationale. The member states have sidelined NATO and the EU in identifying spending cuts. They planned and started to implement their current reforms in a rather uncoordinated manner. At the same time, member states know little about the defence reforms and cuts that their neighbours and alliance partners in EU and NATO have implemented. Hence, they seem to be willing to accept and even actively work towards reduced levels of common security by cutting capabilities without informing one another of the consequences or gaps that are created by the alliance or EU as a whole.

Although a majority of EU Member States is affected, the effects and reactions to economic challenges differ i.e. the consolidation of national budgets has been prioritized along national traditions in economic policy. Despite observable differences a majority of states have been affected by the crisis and have decided on major consolidation measures.

While the EU currently debates and experiences the short term consequences of the financial crisis, the long-term effects are still ahead of the Union's public budgets. According to European Commission estimates, the period of austerity may last for up to two decades until 2030. The exact timeframe depends i.a. on the fiscal discipline Member States show in consolidating public spending. After massive debt-financed recovery programmes the states now seek fiscal consolidation by reducing all public spending over a long-term perspective. Consequently, the consolidation process will have to aim beyond short-term cuts to seek structural spending reforms designed to have an effect in the medium term.

The impact of budget pressure on EU Member States' defence establishments differs significantly from country to country. This diversity is to some extent a matter of political priorities. But it is obviously only a matter of time until the increasing pressure of servicing public debt arrives at the defence budget and forces it to contribute to fiscal consolidation. However, it is questionable whether the required savings can be achieved by simply shrinking the existing national defence structures and armed forces. Especially for small and medium sized countries, whereby keeping their military ambitions has become a costly reality which they cannot escape. The most dramatic cuts of all have taken place amongst the small EU Member States with cuts above 30%. The majority of middle-sized states have implemented cuts on average of 10%. Among the bigger EU Members under pressure, there seems to be the most political and economic room for manoeuvre.

Analysing the current problems and reactions of EU member states, a very heterogeneous picture unfolds. In those states deciding to implement defence-related cuts, the decision on how to distribute savings across the defence apparatus has varied. For instance this study identifies that:

- **Whilst the EU Level of military Ambition (LoA) as well as that of a majority of Member States has not changed officially so far, the UK and Germany have already reduced their ambitions.** A key interest shared among almost all EU Member States is to enhance the deployability and sustainability of their armed forces in distant theatres. To these types of operation, middle-sized and smaller Member States are looking to provide *niche capabilities* and work towards role specialization. The bigger EU countries still aim to maintain *full-spectrum forces*.
- Whilst a majority of EU Member States struggle with **personnel costs, it will be difficult to realize significant savings** in this area over the short or even the medium term due to contractual obligations or military needs.
- **In the area of armaments**, the serious risk of a **growing gap between “modernizers” and “procurement cutters”** increases, due to very diverging reactions to the financial crisis. It may affect the ability of some Member States to contribute to future multinational operations. Generally, cuts in the area of procurement (planned or realized) reached a much lower level across EU member states than discussed at the beginning of national response plans.
- **In the area of Operations and Maintenance**, a majority of Member States used the opportunity to **accelerate the decommissioning of older capabilities**.
- For **international military engagements**, almost no Member State has to date opted for a withdrawal. However, most Member States did reduce the number of troops in certain missions and/or shift their weight across their multiple engagements.
- The **defence industries in the EU** have not been seriously affected by the crisis so far. But a long-term fiscal downturn implies serious programme cuts or delays for almost all EU member states for future programmes. Whilst the demand may be lower and the market volume may shrink, it will come along with increased imperatives for value-for-money. This may turn into additional arguments for EU based companies to further develop footholds in the US and emerging markets like Asia and South America. **Member states with significant defence industry have reacted quite differently so far – in line with their traditional approach to defence industrial policy.**

More recently, Europe has seen a number of bilateral and multilateral initiatives for capability development and a renewed interest in Pooling & Sharing. Whilst the necessary mix for the success of these initiatives is difficult to define some variables play an enabling role, such as regional proximity and similar geographic size; common strategic culture and pre-existing political cooperation as well as the alignment of political interests; and finally, defence industrial relations are likely to be supportive if they are asymmetrical (i.e. diverging industrial landscape that will not suffer from a cooperation induced rationalisation in the industrial sector).

The characteristics of existing examples of Pooling & Sharing (P&S) show the wide spectrum of forms and areas of application international cooperation can take. What items and services can be subject to P&S and what has to be kept purely national varies greatly among Member States. They typically evolve around user groups for equipment or specific capability shortfalls. Whilst they often build on existing cooperation among EU Member States, the majority are not integrated into the EU framework with the exception of EU-Battlegroups. Some of the larger P&S examples were first developed within the NATO context. The majority of analysed Pooling & Sharing initiatives comprise five or less participants.

When assessing the eight most prominent new initiatives, (Franco-British Pact, NORDEFCO, Nordic-Baltic Pact, South Eastern Europe Defence Ministerial process, Visegrad Four, Wiemar Triangle, Franco-German Cooperation, Ghent Process), the study identifies that they vary greatly in number of participants and scope. However, they may be the first sign of a new political momentum for bottom-up processes for



capability development that draws first lessons from the financial crisis and more sensibly take into account the security repercussions of ill-conceived cuts in capabilities.

Entirely new initiatives, inspired by the financial crisis are limited to the Ghent Initiative and the Nordic pact. Besides them, current re-energizing of initiatives builds upon established relations at the highest political levels or upon pre-existing cooperative frameworks, or both. These vary significantly regarding membership, objectives, stages of preparation and output. Moreover, not only multilateral but also bilateral cooperation has been revisited, with the Franco-British pact being the most prominent example.

Still, it remains to be seen whether these initiatives support or undermine CSDP and European capability development in general. Currently, there are mixed attitudes whereby EU Member States can be divided into three groups according to their attitude towards this revival of defence cooperation initiatives. There are the "Activists" that are actively looking for cooperation options or leading efforts in this domain, and including France, Germany, Poland Netherlands Sweden, Belgium, Finland, Greece, Hungary and Bulgaria. There are the "Undecided" who have an ambiguous stance regarding closer defence cooperation within the EU (the UK, Denmark, Italy, Spain, Portugal and Romania) and who may favour e.g. the NATO framework or bilateral formats (French-British Agreement). There are the "Specialists" including a number of smaller states constrained by the proportionate burden a military imposes on a small national economy and who are therefore interested in developing niche capabilities that would ultimately lead to some form of role specialization amongst in the EU.

### **Recommendations: elements of an EU Defence sector strategy**

The EU's current political atmosphere may well limit the appetite for more initiatives towards defence cooperation. However, three arguments highlight why an EU as a capable military actor is a necessity for responsible governments vis-à-vis their populations rather than a question of choice and taste.

1. The US will in future be less available for EU requests for help.
2. EU member states have not been able to ensure their security individually - the effects of the financial crisis reinforce and indeed accelerate this trend. A significant capacity to act can only be generated through pooling at the EU level.
3. Whilst policies for conflict prevention have to play a major role in EU crisis management, the option to resort to military force as part of a political strategy cannot be ruled out.

Using the current financial situation as a turning point to concentrate minds and budgets upon more effective and efficient EU capability generation highlights that Europe needs a defence sector strategy as a comprehensive answer to the problems outlined above. This should include the conceptual, institutional and material links between the armaments phase and the capability development phase as well as increased performance in each phase.

To ensure that CSDP gets reenergized, the challenge is to combine the following elements into a coherent strategy that goes beyond the current incremental approach i.e:

- by using the opportunities offered by Lisbon Treaty, including the EDA and the Commission,
- in addressing the economic crisis by adapting the capability generation framework to the realities of austerity,
- by building upon the various initiatives by EU Member States as well as learning lessons from existing cooperation and turning them into an effective defence sector strategy,

Therefore, this study proposes a more comprehensive approach to the defence sector – overcoming the current piecemeal approach to the various problems. The recommendations concentrate on the shape of an effective EU defence sector strategy during a period of austerity (linking especially the industrial and capability dimensions); the necessary steps to introduce and implement that strategy in practice; as



well as the options for the European Parliament to support Member States in developing such a coherent and comprehensive approach.

It starts with the conceptual link: an EU Strategic Defence and Security Review that would enable a dialogue among EU Member States on the ways and means they have already developed to live up to their obligations in the EU and NATO and how they would like to organize themselves in future, taking into account the circumstances of the financial crisis and national cuts.

To increase the institutional link the full potential of the European Defence Agency (EDA) should be used as a forum and permanent secretariat for multinational projects. Adapting the EDA to the times of austerity should include national finance ministers playing a bigger role. Permanent Structured Cooperation introduced under the Lisbon treaty should be envisaged as a long-term objective that can currently only be achieved by bottom-up generated examples of best practice. These may act as inspiration for further tangible areas of cooperation for Permanent Structured Cooperation..

Linking resources is possible in three different areas: pooling of national Research and Technology funds that are currently under imminent threat because of the financial crisis. The links could be based upon industrial and time-related priorities. Common investment and procurement programmes are an option to consolidate demand. Although prominent examples like the A400 M may reduce the appetite for multinational programmes, it is important to remember the performance of national procurement programmes is not necessarily better. It is important to focus upon the discipline in keeping the harmonisation of the requirements throughout the whole production process. At a different level one can also envisage linking the funding of R&T to the general EU budget via a redefined role of the EDA.

Specifically related to the capability development phase, the study proposes several areas for Pooling & Sharing. It also highlights the opportunity to use the ATHENA mechanism, currently limited to operations as such, to purchase common equipment for EU operations. Likewise, the EU Battlegroups have already shown their utility as a testbed for new military solutions within an agreed political framework. Following on from this positive experience new ideas could be tested. For instance, Battlegroups themselves could be the subject of an intensified and widened Pooling and Sharing approach, allowing for a more complex and real threat related capability. Last but not least, this model of pooled capabilities and very deep military cooperation could be extended to wider military structures.

Engaging with the armaments dimension most effectively requires greater understanding of the industrial policies of EU member states. Far beyond defence specific aspects, Member states would have to develop an understanding about industrial priorities in times of austerity and thus find a formula for a more coordinated European Industrial policy. Here the Commission, including through its defence package, may play a certain role. The next step would then be to elaborate a defence industrial Headline Goal 2030 that sets out common industrial and technological priorities for the EU defence sector. At the same time EU Member States have to engage in greater consolidation of demand through joint R&T projects or through bundling demand for shared capabilities (ie harmonization of demand, synchronization of procurement, cooperative or common procurement). Moreover, defence firms should be encouraged to expand their activities into the security field to buffer against upcoming rationalisation and to offer alternative options vis-à-vis export markets.

The EU Parliament may support these recommendations through its new powers under the Lisbon Treaty in the area of political oversight, budgetary authority and legislator (and as developed in the conclusion).

## **1 INTRODUCTION: EU CAPABILITIES AND THE FINANCIAL CRISIS: RISKS AND OPPORTUNITIES**

The financial crisis can be both for the European defence sector, a risk as well as an opportunity: on the one hand, it sounds plausible that shrinking budgets increase the pressure on member states to cooperate and thus to overcome the EU's problems related to capability development and restructuring of the defence industries and markets. On the other hand, despite a decade of rhetoric and initiatives for more cooperation and less national influence on EU defence, national prerogatives still dominate. If this national focus continues to dominate under current financial circumstances, EU member states run the risk to implement cuts in their Armed Forces in an uncoordinated way. As a result, member states might end up with potentially even bigger capability gaps than they have today and hence even less opportunities to implement the Common Security and Defence Policy (CSDP).

EU member states are unable to guarantee their security individually. This has been the starting point of the European Security and Defence Policy. ESDP so far has allowed to Europeanize the way, European forces fight together they still prepare for these operations individually. Today capability generation in Europe, i.e. capability development through defence planning and the armaments process, is characterized by a plethora of arrangements. However they fail largely to deliver due to conceptual flaws, fragmented processes and missing commitment resources. This is contrasted by a widely shared practice at the national level to waste resources under the disguise of national sovereignty. What they have in common is the underperformance on delivering of operational capabilities.

In this situation national and EU capability generation frameworks are hit hard by the financial crisis, creating a turning point. Member states have to adapt the affected policy areas to the new realities, including defence. While many member states are still in a state of denial, losing the ability to contribute to EU security will soon be felt across Europe, by those who can still contribute and those who lose the ability to do so and by this shape their security.

The initial response of member states to the financial crisis is to evoke the traditional pattern of national prerogatives. More recently, new opportunities surfaced: Europe has seen a number of bi- and multilateral initiatives for capability development, mainly build on existing frames. It remains to be seen whether these initiatives support or undermine CSDP and current efforts to European capability development

To ensure that these initiatives reenergize CSDP, they would a) have to come under the EU-framework, b) the capability development framework itself would have to adapt to the realities of austerity and c) it would have to be linked more closely to the defence industrial and technological dimension of capability development.

Hence, the challenge is to combine the necessities of the economic crisis, the initiatives by the various EU countries and the opportunities the Lisbon Treaty offers into an effective defence sector strategy that goes beyond the current incremental approach.

This study offers MEPs and the European Public a first comprehensive overview of the financial crisis' effects on the defence sector of all 27 EU member states and the EU level, as well as its wider impact on CSDP. It recommends to the EP and other decision makers on how to react to the crisis. Therefore, the study comprises four chapters and an extensive Country analysis of all 27 EU member states in the Annex of this study.

The following chapter gives a brief overview over the well-known challenges in the EU defence sector to deliver operational capabilities for EU Operations. It will address the state of defence transformation and the adequacy of member state capabilities related to current and future threats. It shall give an overview of the problems and effects of duplication of these capabilities as well as that of defence industrial infrastructure. It eventually analyses why these problems exist and why it has been difficult to

overcome them in the past. It also seeks to highlight the growing future risks resulting from leaving these problems unchanged.

In its third chapter the study will evaluate the effects of the financial crisis at national and EU levels in light of the questions raised earlier. All this is based on an extensive country analysis examining the defence sector of all 27 member states. It focuses on recent changes in the following categories: financial context and budget cuts, forces and equipment, international cooperation, defence industrial aspects. Such an analysis should a priori be put in context of the member state's defence sector characteristics. Hence, we divide the countries into three groups according to the size of their defence industry and contributions to EU capabilities: bigger, medium sized and smaller countries.

This analysis will lead to our recommendations to the European Parliament, taking especially into account the new rights the EP holds in the area of CFSP/CSDP. These recommendations will concentrate on the shape of an effective EU defence sector strategy in times of austerity (linking especially the industrial and capability dimension), the necessary steps to introduce and implement it in practice and the options of the European Parliament to support and push the member states for such a coherent and comprehensive approach.

## 2 EU CAPABILITY GENERATION – STATUS QUO AND NEW OPPORTUNITIES

Capability generation comprises three things:

1. The **concepts** that inform about the underlying assumptions regarding specific ends and means. In crisis management this is often provided through scenarios etc.
2. **Institutions and processes** that frame the development process from the production through the maintenance to the deployment of capabilities.
3. The **material resources** that enable the concepts to materialize. As an input to the capability generation process), this is *money* The most visible material output of the capability process is of course equipment but also services like logistics fall under this category.

Capability generation encompasses two subsequent phases:

1. **The Armaments phase:** It comprises **research, development testing and procurement as the** relevant stages of equipment generation. The elements (e.g. knowledge, Installations etc) needed during this phase represent the **defence industrial and technological base** for capability development. Ideally, the core function of the defence and technological base is to equip and supply the armed forces with effective products. Through the development and maintenance of military capabilities it contributes to the state's overall capacity to act.
2. **Capability development phase:** It comprises the **planning, set up, organisation and routine management of armed forces**, i.e. training, exercises, but also services that allow building and maintaining a certain capability.

The conceptual, institutional and material linkage between armaments phase and the capability development is of paramount importance for effective and efficient capability generation as a whole. In particular, such coherence in capability generation creates important advantages or even essential conditions for defence cooperation: what you develop and build jointly - you can easily operate and maintain jointly.

European capability generation is confronted with three main problems. These problems also point towards central chokepoints for more effective and efficient capability generation.

- **capability development: The exiting mechanisms and institutions have created a shared perception of problems and needs, that led to a conceptual basis for capability development**

**(ESS,HG 2010) However, the resulting institutions weren't able to generate a sufficient level of material commitment for the member states to implement their self inflicted conceptual obligations.** The overall method of governance – bottom up voluntary contributions and peer pressure – does make member states to close jointly identified gaps as EUBG and other areas show. The answer to the question, “What forces for what operations” remains too fuzzy and bound to national considerations.

- **Within the armaments phase, it is less the security political considerations that characterize capability generation than the mixture of national industrial and technology policies and structural policy.** These national approaches and the resulting fragmentation of regulation, and demand has led to a host of problems: Institutionally, the armaments domain has traditionally developed outside the EU, based on purely intergovernmental principles like “Juste retour” and Art 346 (ex 296) Lisbon Treaty. EU taxpayers carry the burden of resulting duplication of defence industrial production sites. As these suppliers offer more than the EU market can absorb, Industries are forced into exports. However protected domestic markets with limited numbers of suppliers have not contributed to the competitiveness of producers.
- The EU armaments and the capability development phases **are institutionally and conceptually fragmented and virtually no resources are available for both, besides those controlled by the EU member states. As a consequence, equipment, national and multinational, is always too late, too expensive and too poor in capability performance.**

Several innovations during the last decade have aimed to engage with these problems, especially the poorly developed link between the armaments and the capability development domain. However, it is still the political will of the member states that paves the way towards a greater role of the EU in achieving the desperately needed coherence in capability generation.

The Lisbon Treaty could solve some of the institutional problems among and within the phases. The treaty increased the potential for a more effective capability generation framework. Moreover, two new players in the field of armaments may provide support for a midterm but lasting change. EDA and Commission have already aimed through different ways and initiatives to lower the national walls of the EU's 27 armaments sectors. The EDA can engage with the whole spectrum of capability relevant issues: research & technology, markets & Industry, capability development and armaments. However, its success until today is limited due to the restricted use the member states and especially MoDs make of their agency. Eventually, the EU Commission has succeeded in placing a foot in the defence domains latest step was the defence package. If implemented properly, this could well have significant transformative effects on the defence market and industry.

At the EU level virtually no joint funding for capabilities or equipment exists. Joint spending in the area of armaments is more the exception than the rule: only 20%. Hence it is the member states that fund the military part of CSDP. However, national budget lines are neither related nor equipped to comply with the military obligations EU members have committed to themselves to under the CSDP framework. Instead the main way of financing is either according to the GDP key (see below) or by voluntary contributions.

There is first of all a legal hurdle to transfer financial resources to the defence realm from the community or CFSP budget. Article 41 of the Lisbon Treaty states in Paragraph 2:

“Operating expenditure to which the implementation of this Chapter gives rise shall also be charged to the Union budget, except for such expenditure arising from operations having military or defence implications and cases where the Council acting unanimously decides otherwise.

In cases where expenditure is not charged to the Union budget, it shall be charged to the Member States in accordance with the gross national product scale, unless the Council acting unanimously decides otherwise....”

The EDA activities are financed accordingly. Moreover EDA has only a very small operational budget, limiting its room for manoeuvre. The lion share of the resources can only be invested if the Steering board agrees on projects, the Agency suggests to them. In addition there are *ad hoc* projects also launched in the EDA framework but funded solely by the participating states. Currently, about 300 million Euros are invested in such *ad hoc* projects.

Through the so called ATHENA mechanism only common costs of EU military operations can be financed so far. The common costs are divided up between the Member States based on a GDP index set for each Member State. The ATHENA mechanism has been used for the EU military operations: EUFOR Althea, EUFOR CONGO and EUFOR Chad/CAR.

In parallel, the Lisbon Treaty provides for the setting up of a start-up fund to finance the preparations for EU military operations, which should improve the speed and efficiency of EU action.

## **2.1 The persistent Challenge: ESDP/CSDPs Capability development**

In terms of capability generation, the European states are faced with manifold challenges: They have to maintain the operating and strategic effectiveness of their armed forces while being presented with the contradictory relationship between decreasing resources and increasing numbers of ongoing operations. Despite the military engagements in the Balkans, Afghanistan and Iraq defence budgets have not recovered from their massive cutbacks after the end of Cold War. In those states where defence expenditures have slightly re-increased in the past few years, the added funding has rarely been used for investments in military capabilities or equipment. Frequently, these sums only cover the increased attrition of material due to the many military operations.

The problem is aggravated by the necessary, but cost-intensive transformation of capabilities. Against the background of changing threats, appropriate military equipment not only has to adapt to a new mission spectrum via cost-intensive technological innovations but also has to be interoperable. Since military missions today are mainly undertaken in multilateral frameworks, the use of compatible or jointly developed arms products and maintenance concepts as well as standards and procedures is a key to higher effectiveness and lower costs.

The character of crisis management is also drifting away from purely military tasks. Future engagements are likely to be more civilian and more geared towards managing the complex interaction of several actors to achieve an integrated or comprehensive approach. This poses also challenges to the development of capabilities, i.e. to link planning assumptions and deduce integrated or civil - military interoperable capabilities such as communication, maintenance or transport.

### **EU Capability development**

The EU offers an extensive institutional framework that could well assist member states to gain more "bang for a Euro".<sup>1</sup> The Franco- British St. Malo agreement 1998 and the Cologne Summit in 1999 set the starting point for the evolution of the EU's capability development initiatives. Heads of state and government agreed in Cologne "...that the European Union shall play its full role on the international stage. To that end, we intend to give the European Union the necessary means and capabilities to assume its responsibilities regarding a common European policy on security and defence. (...) The Union must have the capacity for autonomous action, backed up by credible military forces, the means to decide to use them, and a readiness to do so, in order to respond to international crises without prejudice to actions by NATO"<sup>2</sup>

The current framework comprises several actors, institutions and concepts to guide its development. The major implementing tool is the European Defence Agency. Coherence with NATO is aimed to be

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<sup>1</sup> Burkard Schmidt: The European Union and armaments. Getting a bigger bang for the Euro, Chaillot Paper No. 63, Paris August 2003

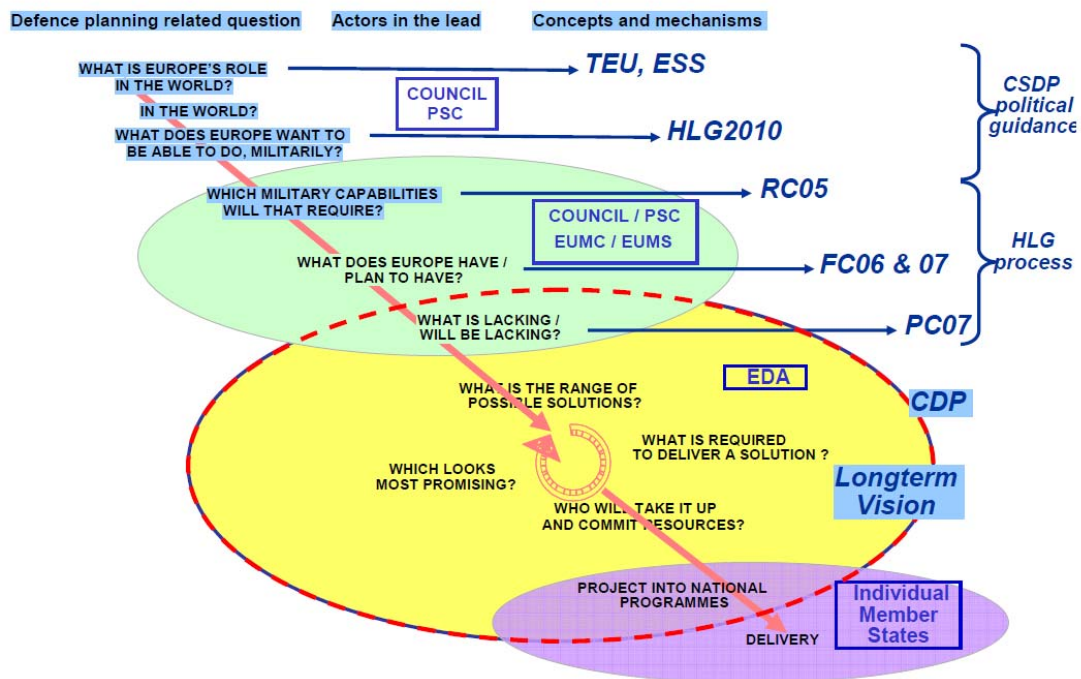
<sup>2</sup> European Council declaration on strengthening the Common European Policy on Security and Defence, Cologne European Council, 1999.



achieved by informal information exchange and the joint EU-NATO capabilities group. New opportunities for the framework are offered by the Lisbon Treaty.

Main EU- actors are the...

- Political and Security Committee (PSC) – It takes the political leadership on behalf of the Council.
- European Defence Agency (EDA) and EU Military Committee (EUMC) which define the military needs.
- EU Military Staff (EUMS) and the Crisis Management and Planning Directorate (CMPD) which support the actors mentioned above



The EU capability development today is driven by several concepts that evolved over the last decade. The European Security Strategy (ESS) poses a watershed for capability development as the ESS led to a comprehensive review and update of the capability goals. These were translated into concrete military objectives, namely the HG2010. The latter also set up the so called Capability development mechanism.

Petersberg tasks (1992): They are the point of reference for the scenarios used to define the capability needs. Under Article 17(J7)(4), the Treaty of Amsterdam incorporated into the TEU the so-called Petersberg tasks: humanitarian and rescue tasks, peace-keeping tasks and tasks of combat forces in crisis management, including peace-making. These have been extended ("Petersberg Plus tasks") by the Lisbon Treaty, which additionally refers to joint disarmament operations, military advice and assistance tasks.

The Helsinki Headline Goal (1999): The EU-states agreed upon a collective capability goal at the EU level - the Helsinki Headline Goal (HHG). With the HHG, they committed themselves to have by 2003 60.000 troops available in 60 days, to remain in theatre for one year, and able to address the full spectrum of the already existing catalogue of scenarios: the "Petersberg tasks".

The December 2003 European Council closed the process initiated in Helsinki although the HHG has not entirely been achieved. In fact, despite quantitatively meeting the targets, significant qualitative shortfalls remained in key capabilities such as transport or force protection. Particular problems have been recognised with regard to the upper end of the spectrum of scale and intensity. Most observers hence claim that the HHG has not been met. ESDP remained a symbolic political move rather than one supported by military-material evidence.

European Security Strategy (2003): The ESS defines strategic objectives and sets out the political implications for Europe. It calls upon the EU member states to become more active, more capable and more coherent and to work with partners. Besides global challenges such as hunger and disease, the ESS lists five threats to security:

- terrorism;
- weapons of mass destruction;
- regional conflicts;
- failure of states;
- organised crime.

The ESS has had a direct impact on the ESDP: it paved the way for the update of the Petersberg tasks, informed the military Headline Goal 2010 and influenced the Capability Development Plan compiled by the European Defence Agency.

Headline Goal 2010 (2004): In May 2004 member states agreed to: "commit themselves to be able by 2010 to respond with rapid and decisive action applying a fully coherent approach to the whole spectrum of crisis management operations covered by the Treaty". The EU's ability to deploy high readiness forces in response to a crisis was considered a key element of the HG 2010 and was to be based on the EU-Battlegroups (BG). BG are rapid response units of about 1500-2500 troops. They are composed of national or multinational contributions under the responsibility of a framework nation.

The HG 2010 comprised further capability development targets. A non-exhaustive overview is given in the table below:

Capability To be developed/	implemented by
Establishment of a civil-military cell within the EUMS	2004
Establishment of the Agency in the field of defence capability development, research, acquisition and armaments (European Defence Agency)	2004
EU Strategic lift joint coordination, with a view to achieving by 2010 necessary capacity and full efficiency in strategic lift (air, land and sea) in support of anticipated operations;	2005
Specifically for Airlift: the transformation of the EACC into the EAC is welcomed, as is the intention on the part of some Member States who so wish to develop a	2004

European Airlift command fully efficient by 2010	
Availability of an aircraft carrier with its associated air wing and escort;	2008
Developing appropriate compatibility and network linkage of all communications equipment and assets both terrestrial and space based	2010
<p>“Declaration on Strengthening Capabilities” (2008): with this declaration, the EU Council made a first step towards a reorientation of the capability development. It set out a new EU level of ambition for civilian and military crisis management missions. The EU should be able i.a. to simultaneously conduct two major stabilisation and reconstruction operations involving up to 10,000 troops plus a civilian contingent; two rapid-response operations using EU-battlegroups; a civil–military humanitarian assistance operation and around one dozen civilian missions, including one major operation involving up to 3,000 personnel. Moreover the declaration advised member states to investigate innovative methods for capability development, including the pooling and multinational management of assets.<sup>3</sup> This level of ambition has not yet been translated into a new HG to generate the necessary capabilities for its implementation. Currently, it only increases the gap between available and intended capabilities.</p>	

### The EU's capability development balance: EU-Battlegroups and a bit more

The main success of the EU capability development mechanisms is to keep member states engaged in capability development under the EU framework. They acknowledge capability gaps and voluntarily commit themselves to seeking ways to solve them. The main problem consists in the mechanisms that do not sufficiently engage the member states. The overall method of governance – bottom up voluntary contributions – did not change from Helsinki to the HG 2010, and no sanction mechanisms have been introduced to monitor the member states commitment. From this perspective, the HG 2010 was more an adjusting of goal posts than an improvement of a method which already showed its limits in the HHG. However, the force generation process under the HG 2010 became auditable: While still based on voluntary declarations, the units and force packages member states offered were peer reviewed by the member states. This increased the peer pressure against free-riding or undercutting of minimal standards.<sup>4</sup> Still, member states cannot be obliged to fill the gaps they have identified.

Hence, the member states certainly have engaged in developing collective military capabilities at the EU level. But they still have to recognise severe shortfalls. In 2009 ESDP reached its 10th anniversary. It changed its name to CSDP<sup>5</sup> after the Lisbon Treaty came into force. However, the main capability shortfalls identified in 1999 and 2003 in intelligence and reconnaissance, strategic and tactical transport, and force protection all still persisted. A quantitative assessment indicates that some progress has been made in terms of national military reform. But this is not identical with EU military capabilities.<sup>6</sup>

The capability development and the force generation are thus still not linked up – one could speak of a “capability-operation” gap. Instead, the Member States - within the EU-framework- have repeatedly failed to develop effective military capabilities because they were either unable or unwilling to commit themselves to joint military operations. The EU-Battlegroups have not been used and neither has one of the many capability catalogues and plans played a major role in the set up of recent operations. The EU prefers setting up ad hoc force generations processes.

<sup>3</sup> International Institute for Strategic Studies, *The Military Balance 2010*, London, Routledge 2010.

<sup>4</sup> Claudia. Major and Christian Mölling: 'EU Military Capabilities - Some European Troops, but not yet a European Army', in: Ettore Greco, Nicoletta Pirozzi, Stefano Silvestri (eds.), *EU Crisis Management: Institutions and Capabilities in the Making*, IAI Quaderni English Series No. 19, Rome, November 2010, pp. 11-28.

<sup>5</sup> Common Security and Defence Policy

<sup>6</sup> Daniel Keohane and Charlotte Blommesteijn, *Strength in numbers? Comparing EU military capabilities in 2009 with 1999*, Paris, EU Institute for Security Studies, 2009 (ISS Policy Brief December 2009)



At least to some extent the EU-Battlegroups are a success story. They delivered where all earlier initiatives failed: setting up a functioning capability generation mechanism with a palpable output: since 2007 two EU-Battlegroups are always on standby. EUBG have significantly intensified the defence cooperation among EU-states, which comes with a socialisation of decision-makers in EU security affairs. However, the price for this is military ambiguity. The minimal criteria for participation have been watered down to allow every nation to participate. In turn military effectiveness cannot be assured for all formations. The EU-Battlegroups have an important transformation effect. It is however limited to the very small portion of troops that participated in the formations. Consequently, they did not have a structural impact on defence reform.<sup>7</sup> Moreover, EU-Battlegroups haven't yet been deployed –they are thus virtually non-existing in operational terms. Besides the Battlegroups, also command and control are available at the EU level thanks to the five EU-earmarked national Operations Headquarters. The limitations for strategic transport have been eased to some extent the "Strategic air lift interim solution (SALIS).

## **2.2 Armaments: The EU's limited defence & technological base**

Contrary to the EU capability development, institutions and concepts are less developed within the Union. The sector is traditionally shaped by national armaments policies on the one hand and internationalized market- and production structures on the other. Cooperation and institutions have evolved mainly outside the EU.

Against the dream of national security and independence of supply has become quite unaffordable, and out of tune with the reality of the EU. Instead, international dependencies in production, supplies and services will become the norm. Today running national military machineries has become highly dependent on non-national service providers and suppliers. The question is no longer how much national independence would cost, but simply how Europe can uphold an effective spectrum of capabilities and the associated Defence industrial and technological base (DITB).

### **The structural obstacles to improving European Armaments cooperation**

Art 346 and the principle of *juste retour* kept the armaments sector a purely intergovernmental business. Its structure is hence characterized by the obstructing diversity of EU member states approaches to policy of defence, market, technology and industry.

Armaments cooperation in Europe is traditionally determined by ad-hoc programs and has hardly experienced any restructuring initiatives yet. There are four main reasons for this. First of all, many arms-producing states continue to perceive their national independence and the security of supply to their armed forces as being linked to the maintenance of their own armaments industry. Secondly, the divergent national security concepts result in different demands for capabilities and correspondingly different role conceptions for the national defence industries. Thirdly, there are varying views as to the role that the state should adopt towards its own defence industry – as a regulator, as a shareholder, and as a customer. Fourth, only very few European countries possess a comprehensive production infrastructure of their own. This results in heterogeneous procurement and market policies. Arms-producing countries often prefer the products of their own industry. Moreover, among the bigger producing countries, France, Germany, the UK or Italy, there is a continuing tendency to maintain as broad a range of national production capacities as possible. Non-producing countries, on the other hand, do not even necessarily purchase their defence products on the European market, but choose other suppliers, especially from the US.

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<sup>7</sup> Claudia Major and Christian Mölling, EU-Battlegroups. Bilanz und Optionen zur Weiterentwicklung europäischer Krisenreaktionskräfte, Berlin, Stiftung Wissenschaft und Politik, 2010 (SWP-Studie 2010/S 22, August 2010)

The remarkable progress of Common Security and Defence Policy (CSDP) in recent years has given rise to new hope that systematic European armaments cooperation can be set up within the framework of the EU. However, the main obstacles have not been overcome so far. These are...:

- **Article 346 TFEU (ex 296 TEU).** EU member states traditionally treat the area of armaments as their *domaine réservé*. This exemption is enshrined in Article 346 TFEU Treaty of the functioning of the European Union. According to the article, a Member State '...may take measures as it considers necessary ... for the protection of the essential security interests... connected with the production or trade of military items...'8 Consequently, the area of armaments is de facto excluded from the EU integration process. Although Article 346 principally allows using market instruments wherever possible, the Member States have regularly resorted to the derogation clause in order to escape from Community procedures. **This practice and the absence of a binding EU framework have led to the current fragmentation of the defence market in terms of demand, regulations, standards and supply.**
- **Principle of *juste retour*:** EU member states institutionalized the rule whereby **in multinational state based armament projects instead of market mechanisms the national work-share equals the national financial investments.** Accordingly, if e.g. Germany pays for 40% of the project costs German companies receive contracts worth these 40% of the overall project budget. It does not matter whether a German contractor actually exists or can deliver the required quality and quantity.

Since the end of the Cold War, the parameters of the sector have changed significantly but also asymmetrically. As a result, the rationales of the market and those of armaments policies are occasionally at odds with one another. While economic considerations militate in favour of an internationalization of supply and demand, defence- and procurement planning generally remains limited to the national level. This is due to the dilemma of a common armaments policy, which makes sense economically, but also threatens to undermine the sovereignty of the individual state by maintaining its ability to defend itself. However, it is becoming more and more obvious that national armaments policies in Europe are coming under increasing pressure to adapt.

While coordination between the various national armaments policies seems advisable, no such systematic approach can be discerned so far. Efforts towards a more efficient European armaments policy have chiefly increased the institutional diversity in Europe, with the result of overlapping memberships and potential responsibilities. Several loose forms of intergovernmental armaments cooperation have emerged since the 1990s. Within the framework of the Western European Union (WEU), the Western European Armaments Group (WEAG) and the Western European Armaments Organisation (WEAO) were created in order to coordinate research and arms procurement. In the "Letter of Intent" (LoI), the six major EU arms-producing countries (France, Germany, United Kingdom, Italy, Spain, and Sweden) agreed to coordinate the restructuring of their defence industries and to make it easier to engage in cooperative arms projects. Another body based on a limited membership is the *Organisation conjointe de coopération en matière d'armement* (OCCAR). It serves as a management organization for multilateral arms procurement projects. Additionally, several NATO bodies deal with the coordination of procurement, standardization, interoperability, and research and development.<sup>9</sup>

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<sup>8</sup> Treaty on European Union, Article 296b. See: <http://eur-lex.europa.eu/en/treaties/dat/11992M/htm/11992M.html>.

<sup>9</sup> relevant NATO Agencies are NAMS - NATO Maintenance and Supply Agency, NETMANATO Eurofighter and Tornado Management Agency, RTO - NATO Research and Technology Organisation (RTO)

## **States, industries and markets in defence - a relationship under pressure to adapt**

Given these changes and their effect on the defence industrial and technological base, the question is no longer which capabilities should be preserved by the nation-state, but which ones Europe requires. Today no single European state retains the ability to produce and develop the entire range of capabilities on its own.

While the European states hesitate to overcome the fragmentation of their armaments policies, many of the structures and processes related to the defence market and armaments production have become strongly internationalized. Defence companies are competing in an increasingly globalised environment for profits and market shares.

These changes were due to the sharp reductions in defence budgets in the 1990s. Like the US, Europe experienced a consolidation of production capacities through acquisitions, mergers and rationalization efforts. The result was a concentration of production capacities in the shape of large, occasionally multinational defence corporations such as BAE Systems or EADS. At the same time, the network of subcontractors, i.e., suppliers of components and parts, has become more transnational. Due to the decline of domestic demand, there is an increasing need to boost exports in order to ensure that production lines operate at full capacity and to remain competitive regarding unit prices via “economies of scale”.

Thus, the shrinking of markets has led to their globalization. This tendency is likely to continue as long as investments in the domestic markets do not increase significantly. However, these developments have not extended equally to the whole defence industrial sector. The consolidation of production capacities and the creation of multinational corporations in Europe have primarily affected the aerospace and electronics sectors. The market segments for land-based and maritime systems remain fragmented.

This fragmentation results from the structure of regulatory policies towards the European armaments sector. Due to heterogenic national rules and procedures for procurement, competition etc. it consists of several small national markets instead of a single but bigger European one.

The consequences are severe for both supplier and demanders. The fragmentation of demand lowered the influence of the individual demander vis-à-vis the producer and the product specifications. Parallel to the downsizing of armed forces the procurement budget shrunk. Lesser demand however led to higher per unit costs as investments had to be allocated to smaller production lots. Thus the state today pays to some extent more because it buys less.

For suppliers, to compensate to some extent for these price increases, the participation in the international markets and production chains has become indispensable. Here, especially small and medium-sized companies - without national branches in every important state - depend on simplified access to these markets. However, not only they but all non-domestic suppliers collide with the prevailing practice of governments. The governments protect their national markets and suppliers e.g. through individual procurement policies and regulations for tenders. They tend to prefer domestic contractors and hinder international competition and participation in domestic tenders. Exempted from this practice are only major companies that act as prime contractors in intergovernmental framed multinational procurement projects. However, such projects reify the principle of protectionism through the “juste retour” practice. It guarantees the distribution of the budget to the participating suppliers along a politically consented distribution key.

The resulting deficient competition among producers as well as different forms of state aid led to the duplication of production capacities and of research and development activities. At the same time many producers are losing their potential international competitiveness and market shares due to the national protectionist measures. In parallel, other uncompetitive domestic suppliers are kept alive without being forced to adapt to the current state of market affairs or cutting edge products.

Consequentially, products of these domestic suppliers are becoming less attractive or affordable for European customers as the latter have to insist on best value for money due to the known budget restrictions.

Ironically, this fatal circle exists if even these state measures fail to produce the necessary revenues for the domestic producers. Then they have to engage into competition on international markets. Here, they experience the discrimination against non-domestic supplier. Additionally, as they adapt their product range towards the export markets they discover that equipments requirements are rather heterogeneous due to incompatible national armament policies. Accordingly, they may be less able and willing to deliver those products demanded domestically. In turn, some states that have a long tradition in state subsidies to their defence industry find themselves left alone once "their" companies adapt to the market structure.

The prevailing pursuit of national armaments policies no longer reflects the market realities of the armaments sector. While the current practice attempts to ensure the survival of individual companies in the short term, in the longer term they prevent the necessary consolidation of the defence industrial sector in Europe. Economic pressure towards structural changes that can enhance efficiency and reduce costs is obstructed.

### **2.3 The European Defence Agency – linking capabilities to defence industry& technology**

The European Defence Agency (EDA) represents the missing link between the capability development and the armaments phase. Its mandate reflects all aspects of the armaments sector in Europe: Capabilities, Research and Technology, Armament and Industry and the Market. However, the EDA's room for manoeuvre is limited. Consequently the success of first projects and activities has been marginal. Main achievements have been possible in short term pragmatic programmes such as helicopter pilot training. But also the joint investment programmes seem to increasingly attract member states.

The European Defence Agency (EDA) represents the missing link between the capability development and the armaments phase. It has the task of supporting the EU states in the development of military capabilities for crisis management operations. In this context, its agenda reflects all aspects of the armaments sector in Europe. Its purpose is to coordinate, optimize, and harmonize co-operation between the member states. Hence, EDA activities should be seen as a contribution to the overall effort of EU institutions involved in capability generation.

However, the EDA's room for manoeuvre is limited. As an intergovernmental institution, its task is to support the EU member states. Besides, Article 346 (ex 296) of the Treaty of the Functioning of the European Union (TFEU) de facto exempts the armaments sector from any EU- Community initiative and regulation. Accordingly, the success of the EDA as well as any initiative from the EU- Commission depends on the political will of the national governments.

Given these constraining factors, it is not surprising that EDA's success has so far been limited. Starting with a very broad mandate, the agency soon felt the limitations imposed by the member states. The first projects have severely suffered from the ongoing influence of the intergovernmental structures that hamper economic rules to be applied to the armaments sector. The future of the agency will especially depend on the question whether it will gain control over some big future armaments programmes such as UAVs or bigger land system procurement.

The EDA has already taken some initial steps towards a more Europeanized armaments policy. For example, the inefficient WEAG and WEAO were dissolved and their projects transferred to the EDA. Furthermore, initial successes are being registered in the regime (Code of Conduct on Procurement) created in 2006 to promote international tendering of procurement projects and in the joint investment program in the area of research and technology.

Through different ways and initiatives, EDA aimed to overcome the national walls that still protect the EU's 27 armaments sectors. However, only a marginal amount of money and number of contracts have come under the voluntary EDA Code of Conduct on Procurement. It failed until today to have any structural impact. None of the bigger member states has shown great appetite to buy equipment abroad. In 2010, the EU armaments sector is far away from showing a tendency towards a single set of commonly accepted and exercised rules and harmonized procedures on competition, procurement, and export. The lion share of procurement remains outside the EU-framework. No big armament programme so far has come under the control of the Agency.

EDA activities in the context of the EU do not draw on EU Budgets in terms of community or CFSP budget. The EDA is funded by its members in proportion to gross national income (GNI). While the starting budget in 2004 was 1.9 million Euros it reached 31 million Euros in 2010. However, EDA has only a very small operational budget, limiting its room for manoeuvre. The lion share of the resources can only be invested if the Steering board (composed of defence ministers) agrees on projects the Agency suggests to them. In addition there are *ad hoc* projects also launched within the EDA framework but funded solely by the participating states. Currently, about 300 million Euros are invested in such *ad hoc* projects (For examples see below).

### EDA tasks and projects

As stated in the EDA Financial Report 2009, the Agency „...has been created to help EU Member States to develop their defence capabilities for crisis-management operations under the European Security and Defence Policy. The Agency's activities are divided into four sectors: Capabilities, Research and Technology, Armament and Industry and the Market. Article 45 of the Lisbon Treaty defines EDA's major tasks:

- contribute to **identifying the Member States' military capability objectives** and **evaluating observance** of the capability commitments given by the Member States;
- promote **harmonisation of operational needs** and adoption of effective, compatible procurement methods;
- **propose multilateral projects** to fulfil the objectives in terms of military capabilities, **ensure coordination of the programmes** implemented by the Member States and **management of specific cooperation programmes**;
- **support defence technology research**, and coordinate and plan joint research activities and the study of technical solutions meeting future operational needs;
- contribute to identifying and, if necessary, implementing any useful measure for **strengthening the industrial and technological base** of the defence sector and for improving the effectiveness of military expenditure.”

The Agency will achieve its goal by encouraging EU Governments to spend defence budgets<sup>f10</sup> Consequently, EDA has undertaken several initiatives to involve its member states in common and better funding:

In the field of defence R&T, the EDA promotes the development of flagship projects such as the Force Protection programme (protection of forces in urban environments) bringing together 20 European states and with a budget of 55 million Euros over three years; the ESSOR (software defined radio) programme involving six European states and a total budget of more than 100 million Euros; and the projects for the integration of unmanned aerial systems in controlled air space (MIDCAS) and for an unmanned maritime system (2010).

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<sup>f10</sup> <http://www.eda.europa.eu/WebUtils/downloadfile.aspx?fileid=1209>

The EDA also works to strengthen the EDTIB. The Code of Conduct on Defence Procurement that came into force on 1 July 2006 is a legally non-binding arrangement. States that have signed up to it undertake to open up their defence equipment markets and to publish their invitations to tender on the EDA website, on Electronic Bulletin Board 1 (EBB 1). This contributes to more transparency in the field of defence equipment procurement of the value of the overall contracts advertised on the site. A related EDA initiative is the Code of Best Practice in the Supply Chain which encourages European companies (as project managers) to publish all contract opportunities for small and medium-sized defence companies on the Agency's Electronic Bulletin Board 2 (EBB 2) in order to give them better access to defence contracts. The 2009 Code of Conduct on Offsets is part of that same approach. The EDA has drawn up several major strategies reflecting its principal aims: the Long-Term Vision (2006), the European Defence R&T Strategy (2007) and an Armaments Strategy (2008). The Long-Term Vision adopted in October 2006 was a major initiative providing guidance for R&T activities with a view to developing capabilities for horizon 2025.

In 2009 financial achievements included:<sup>11</sup>

- the launch of 59 operational projects for a combined value of € 7.7 million;
- the commitment of 10 new contracts for combined value of € 29.9 million during the third year of the Joint Investment Programme Force Protection ("JIP-FP");
- the launch of 12 Ad hoc Category B projects signed in 2009 for a total value of € 40.9 million (government and industry contribution).

### **Helping to close the capability gaps: The Capability development plan**

EDA was especially tasked by the participating member states to implement the Capability Development Plan (CDP). The CDP was designed as an instrument to let those capability needs resulting from the agreed joint level of ambition - the HG 2010 – materialize. It provides a significant corpus of analysis of capability needs, capability trends and potential capability shortfalls up to 2025 and a database of national plans and priorities which will help the member states to identify and exploit areas of common interest and opportunities for cooperation.

The Capability Development Plan (CDP) approved in July 2008 builds directly on the Long-Term Vision and feedback from the numerous missions conducted by the EU since 2003. The resulting picture has led to a series of conclusions and set of 12 high priority actions, that were selected by the Steering Board:

1. Counter Improvised Explosive Devices (C-IED)
2. Maritime Mine Counter Measures (MMCM)
3. Chemical Biological Radiological and Nuclear (CBRN)
4. Counter Man Portable Air Defence Systems (C-MANPADS)
5. Network Enabled Capability (NEC)
6. Intelligence, Surveillance and Reconnaissance (ISR)
7. Improving Helicopter Availability for Operations
8. Medical
9. Third Party Logistic Support (TPLS)
10. Comprehensive Approach
11. Computer Network Operations
12. Human Intelligence

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<sup>11</sup> <http://www.eda.europa.eu/WebUtils/downloadfile.aspx?fileid=1209>



This as well as instant demands in relation to capabilities has led to a rather high number of projects and activities. Although these lists of projects might seem impressive for such a small agency, its work is nevertheless limited due to the above mentioned restrictions imposed by the member states.

- **European Air Transport Fleet (EATF)** based on the pooled acquisition of airlift assets, an option currently under consideration to enhance EU capacities in strategic lift. The EDA contributed to setting up the EATF, implementing all forms of cooperation between the different European air transport operators (in terms of training, acquisition, delivery, logistics, planning and conduct of transport operations). The impetus that the EDA has given to improving helicopter availability (modernisation of fleets and training of crews) follows the same logic,
- **MUSIS (Multinational Space Based Imaging System)**, coordinated by the EDA and involving Belgium, France, Germany, Greece, Italy and Spain, is essential for the EU. Its aim is to develop a space imaging system for defence and security purposes in order to increase Europe's strategic autonomy and strengthen its decision-making capacities in the military field.<sup>12</sup>
- **Software Defined Radio**, including management of the €125 million, six-nation ESSOR project which aims to improve interoperability of future SDR systems;
- **CBRN, Chemical Biological Radiological and Nuclear**, especially looking at Explosive Ordnance Disposal (EOD) of CBRN weapons and devices and Detection Identification and Monitoring (DIM) of CBRN hazards, including Toxic Industrial Materials (TIM);
- **Maritime Surveillance(MARSUR)**, more precisely the development of Maritime Surveillance networking capabilities, the launch of a programme on a Maritime Tactical Unmanned Aerial System and new capabilities for identification of small and no cooperative targets;
- **21st Century Soldier System**, Non Lethal Capabilities, enhanced armoured protection and enhanced battlefield awareness are all developing capabilities, these different systems need to be introduced in a coherent, interoperable and effective manner;
- **Helicopters Training**, to quickly improve helicopter availability. Helicopter crews in some European countries are not trained to fly in more austere conditions, such as mountainous terrain. The Agency is developing a "Helicopter Tactics Programme" (HTP) for such training at the European level.
- **Unmanned Aerial Systems (UAS) Air Traffic Insertion:** The projects work towards common and accepted standards of operation to enable integration of these systems into General Air Traffic or non-segregated airspace.
- **Military airworthiness Authorities (MAWA) Forum** The MAWA forum aims to progress harmonisation of national airworthiness activities. The forum is managed and coordinated by the EDA, who provides the organisational and administrative support.
- **Counter Improvised Explosive Devices (C-IED)**, where the Agency has developed several work strands such as training courses on specific C-IED and Explosive Ordnance Disposal (EOD) aspects., a mobile field laboratory for forensic research of IEDs,
- **Network Enabled Capability (NEC)** aim to ensure that communication and information technologies are exploited so that information can be shared and made actionable. It involves not just the development and deployment of technologies, but agreed doctrine, concepts and common standards, so that all actors can benefit from the knowledge.
- **Third Party Logistics Support (TPLS)** gives economic operators the opportunity to advertise their services alongside a Catalogue of Services covering the whole spectrum of logistic support whereas contracting authorities have the possibility to search for commercial solutions for mission and operation-related logistics

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<sup>12</sup> [http://www.assembly-weu.org/en/documents/Fact%20sheets/15E\\_Factsheet\\_EDA.pdf?PHPSESSID=f3137d60](http://www.assembly-weu.org/en/documents/Fact%20sheets/15E_Factsheet_EDA.pdf?PHPSESSID=f3137d60)

- **Joint Investment Programme-Force Protection (JIP-FP)** is a mechanism for EU collaborative action in Defence Research and Technology. It focuses on technologies for protecting EU armed forces against threats such as snipers, booby traps and improvised bombs, establishing the three-year Programme worth € 54.93 million and involving 20 European governments
- **Joint Investment Programme-Innovative Concepts and Emerging Technologies (JIP-ICET)**, devised by EDA, for research into emerging technologies which might have a disruptive effect on the battlefield

## 2.4 EU Commission- increasing its role <sup>13</sup>

While the majority of members states aimed to keep armaments issues their domaine reserve, the EU Commission has succeeded to establish a firm stance at the intersection of defence vis-à-vis issues of internal market, industrial policies and research. It may be the only actor that can effectively establish a framework for competitiveness through defence specific legislation and policies.

A litmus test for the Commissions future role will be the implementation of the defence package, a set of two directives that offer a harmonized legal framework for procurement and transfers of military items. The package not only engages with the member state dominance in the armaments domain. If implemented it could also lead to a profound change in procurement practice.

The EU- Commission has acquired over the last years a serious reputation in the area of EU security and defence policy. Many EU member states always aimed to keep armaments issues a domaine réservé. Although member states suffer from the current market structure, they insist on the non-responsibility of the Commission for this policy field and deny the Commission's expertise in security political issues.<sup>14</sup> The Commission perceives itself as the guardian of principles like the single market, fair competition or free trade.

It has developed a footprint in defence through the intersection of defence and non-defence issues in three areas:

- Backed by the jurisdiction of the European Court of Justice (ECJ) the Commission has increasingly called for the introduction of **Internal Market elements** into the EU defence sector (DG Market).<sup>15</sup>
- In **industrial policy** (DG Enterprise) The key objective of the European Commission's defence industrial policy is to develop an innovative and competitive European Defence Technological and Industrial Base (EDTIB). A competitive EDTIB is also required to provide Europe with affordability and the ability to cooperate internationally in the development and production of defence equipment.
- In **research** (DG research) especially, through the recently set up security research programme.

Moreover the Commission may be the only actor that can effectively establish a framework for competitiveness through defence specific legislation as it has done through the defence package for Transfers and Procurement (see below). Equally the commission can set up defence specific or related policies and regulations e.g. for SMEs or standardization. Intergovernmental initiatives have failed so far. (See EDA above)

### Procurement and Transfers - The 2009 Defence Package

The recent (2009) Commission initiative, the so called *defence package*, bears revolutionary potential: its two Directives address defence and security procurement and intra-EU transfers of military goods. This

<sup>13</sup>James Copping: EDA – EU Commission relations: Defence Package and related activities <http://www.defensa.gob.es/dgamue2010/PresentacionesSeminario1/Madrid%20EDA-CION%20relations%2015%20Feb%202010.pdf>

<sup>14</sup> Martin Trybus 2004: The Limits of European Community Competence for Defence European Foreign Affairs Review 9: 189-217.

<sup>15</sup> European Commission, 2006: Consultation Paper on the Intra-Community Circulation of Products for the Defence of the Member States, Brussels March 2006: 3



not only engages with the member state dominance in the armaments domain. If implemented it could also lead to a profound change in procurement practice.

The Defence and Security Procurement Directive covers military and sensitive security equipment (and associated services and works), thus equipment that may be exempted from the current public procurement regulations through Article 346 TFEU. It sets Community procurement rules which are adapted to the specificities of the defence/security sectors. It allows, for example, the use of the negotiated procedure with publication as the standard procedure and provides special provisions for security of supply and security of information. The new directive still allows for specific exemptions from competition. However, their use is limited to truly exceptional cases. It aims to open the European Defence Market to increased levels of competition. Therefore, observers anticipate that a far greater proportion of defence and security requirements will be advertised. However, there is a serious exemption: Cooperative armament programmes, one of the most expensive, time consuming and inefficient ways to generate capabilities, are excluded from the new procurement rules.

The Directive on EU transfers of Defence-related products engages with the divergent national systems to control the transfer of defence equipment to another EU member state. Two problems entail both costs as well as a significant level of uncertainty. First, there is no formal distinction between transfers within the Union and exports to third countries outside. Second, although such licenses are granted on a routine basis, they cause a considerable amount of red tape, disturb the smooth running of inner-European production processes and endanger the security of supply between member states. The directive introduces a EU-wide licensing and certification system without sacrificing member states' control over their essential defence and security interests. Certification is granted at national level and is meant to testify the special ability of defence undertakings to handle defence-related products.<sup>16</sup>

### **Security research in the 7th framework research programme**

Under the heading of the 7<sup>th</sup> framework research programme, the Commission has set up a Security Research programme. Given the constant blurring boundaries of security and defence this programme has been perceived by many as another foot of the Commission in the door of defence issues. Synergies and added value of the programme increase tremendously if the results can be transferred into the defence domain. This opportunity is especially given in those cases where companies participate that produce for both the security and the defence domain.

The Security Research programme is exclusively dedicated to civil applications foci and supports the implementation of Community policies and initiatives relevant to security such as the establishment of an area of freedom, security and justice, transport, health, civil protection, energy, environment and external policies. It aims i.e. to develop technologies and knowledge for building capabilities needed to ensure the security of citizens from threats such as terrorism, natural disasters and crime, while respecting fundamental human rights including privacy.

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<sup>16</sup> C. Mölling: Options for a Regime on Intra European Transfers of Defence Items. In: Daniel Keohane (ed): Opening Europe's Defence Market. Chaillot Paper 113, Paris, EU ISS, 2008: 51-88.

## 2.5 The Lisbon Treaty- institutional innovations but political inertia

The Lisbon treaty offers an innovation package that allows improving the coherence of the overall institutional framework. Especially the protocol on *Permanent Structured Cooperation (PSCoop)* could strengthen the area of EU-capability generation, bolster the link towards the armaments framework and reinforce EDA's role. This new cooperation mechanism shall allow capable and interested EU member states to enhance their cooperation in the in the area of capabilities, equipment and forces. It opens up a midterm perspective for savings in national defence budgets through joint projects and maintenance.

However, member states have been reluctant so far, to table tangible suggestions to implement PSCoop, let alone to commit themselves to precise projects. The current stalemate: results from ambiguous political visions and strategic objectives: an unclear road to implementation and a missing financial boost: given the current financial crisis.

The Lisbon treaty comprises a series of innovations designed to increase the coherence and capabilities of the EU as a security actor. It affects the area of CSDP in two ways. First, the general harmonization of the overall institutional framework should facilitate relations between the Council and the Commission with respect to crisis management issues. Second, several articles in the treaty intend to strengthen the area of capability generation. These elements have to be seen in conjunction.

### Institutional coherence and conceptual progress

The Lisbon Treaty confirms the commitment of the EU to the progressive framing of a common defence policy. It aims to give ESDP a new quality by changing the name into CSDP – Common Security and Defence Policy. The aim of CSDP is to provide the EU with an operational capacity drawing on civilian and military assets. As for the operational scope, the treaty for the first time includes the extended list of Petersberg Tasks.

However, it doesn't touch upon several thorny issues: The principle of unanimity remains a cornerstone of security and defence cooperation in the EU. While Qualified Majority Voting applies in some cases for CFSP, it is excluded altogether when it comes to decisions that have military or defence implications. Any modification of this provision is explicitly excluded. The Lisbon Treaty states that "national security remains the sole responsibility of each Member State."

One of the most important institutional innovations concerns the creation of the post of a High Representative of the Union for Foreign Affairs and Security Policy (HR). This post aims to allow EU external policies to be formulated and implemented more coherently and to provide Europe with a visible and continuous representative. It integrates the former positions and functions of the EU Commissioner for External Relations and the High Representative for the Common Foreign and Security Policy, which are in turn abolished. Acting as vice-president of the Commission the task of the HR is to assure effective inter-institutional coordination between Community elements of EU external relations and CSDP.

The treaty also refers for the first time to the European Defence Agency (EDA), which was set up by the EU member states in 2004. Furthermore, it introduces a solidarity clause and a mutual defence clause. The former obliges the member states to support each other in case of a terrorist attack or a disaster. The mutual defence clause compels them to offer aid and assistance if one of them is victim of an armed aggression on its territory. However, this clause explicitly does not affect the national defence policies of member states, their neutrality, or alliances. It confirms NATO as the basis for the collective defence of its members.

Both clauses together cover the full spectrum of scenarios that may require EU member states to provide mutual assistance. While they leave the decision on the kind of assistance to the member states,

they offer a legal formula for the use of civilian and military assets within the EU territory at the request of an individual member state and with the consent of the EU.

### **Permanent Structured Cooperation**

In the area of capability development, the Lisbon Treaty envisages „permanent structured cooperation” in defence issues (PSCoP). This new cooperation mechanism shall allow capable and interested EU states to enhance their cooperation in the in the area of capabilities, equipment and forces. Thus, once implemented, PSCoP potentially has a double impact: first, it enables the EU member states to engage in a more coherent development of the desperately needed military capabilities. Second, it opens a midterm perspective for savings in national defence budgets through joint projects and maintenance.

However, until today EU-states have avoided to table tangible suggestions to implement PSCoP, let alone to commit themselves to any precise project. Three issues add to the current stalemate:

First, ambiguous political visions and strategic objectives: Many ideas are in the air, but they are rarely compatible. Moreover, current debates in policy and academia alike are short of precise examples about what PSCoP could achieve for the states and the EU. They neither address nor compare with other options such as the cooperation within EDA. Nor do they outline direct revenues of participation in PSCoP.

Second, the road to implementation is not clear: The discussed principles and criteria to define the implementation of PSCoP are rather abstract. What lacks is an evolutionary approach that would build on existing cooperation projects and preferences in the area of defence and that would seek to answer the question what member states want to achieve with PSCoP and how these varying interests could be integrated.

Third a missing financial boost: PSCoP implementation is hit by the current financial crisis. Given the difficult state of debate the member states consider investment in PSCoP as a financial risk. National decision makers find themselves unable to organise the financial basis for a rapid transformation into a more EU-focused defence economy that would generate midterm cost savings and a more coherent capability basis for EU-forces.

Consequently, PSCoP is at the crossroads: missing specification and lack of insight in what, who and how. In addition, the bargaining tactics of the member states risk to fizzle out the implementation process. This would not only mean to miss an important window of opportunity for defence cooperation. PSCiD is also the only palpable novelty in CSDP. Failing to deliver in PSCiD would seriously damage CSDP.

The objective of PSCoP is to enhance the EU’s operational capabilities through collaborative efforts. Yet, many of the provisions on PSCoP are still vague. This is especially true for the kind of cooperation that can come about under PSCoP – in terms of content, with regard to outcomes, and in terms of who will or can participate.

With regard to participation, PSCoP will operate on an opt-in basis. Accordingly, there is no obligation for member states to take part. It is open to those member states that meet two criteria: First, their willingness “to proceed more intensively” to develop their defence capacities through the development of their national contributions and participation in the respective multilateral endeavours; and second, their capacity to supply capabilities, either at national level or as a component of multinational force groups, structured at a tactical level as a battle group.

Concerning the first criterion, its main deficit is the lack of any benchmark. As for the second criterion, all it asks for is some marginal participation in an EU Battlegroup (EUBG). In fact, PSCoP was one of the driving forces behind the participation in EU BGs for many smaller states, as they did not want to be perceived as second-class members. However, they did not want to engage in costly capability development for EU BGs either. By eventually succeeding in watering down EU BG entry criteria, they

also ended up blurring the idea of PS Coop. What was originally designed as an exclusive club has lost much of its distinctive character – which is bound to have negative effects on the quality of PS Coop.

## **2.6 Potential areas of permanent structured cooperation indicated in the protocol (article 2)**

- Ensure level of investment expenditure on defence equipment
- Synchronization of national defence apparatuses
- harmonization in identifying requirements
- pooling or role specialization
- cooperation on training and logistics
- Enhance the ability to commit forces, particularly through...
- enhancing availability, interoperability, flexibility, deployability
- identification of common objectives for commitment
- review of national decision-making procedures
- Bi- or multinational cooperation to remedy shortfalls of the “capability development mechanism”
- Joint equipment programs under EDA framework

However, the protocol does not specify projects or other substantial elements of cooperation. Currently, the EU governments seem to have no precise idea on how to use PS Coop. Basically, two options can be imagined: to integrate existing multilateral projects into the framework of PS Coop, or to establish new ones. With regard to the former, a potential initiative is the so-called LoI (Letter of Intent) Agreement among the major European arms-producing countries.

The advantage of starting with existing projects is that the partners know each other and are accustomed to a certain routine and culture of cooperation. But under which circumstances would these projects be open for participation by new members? States that already participate in such frameworks are likely to be reluctant regarding unconditioned enlargement. Especially if new members are integrated for political rather than substantive reasons, cooperation would be obstructed rather than intensified, leading to less than optimal effectiveness. Although PS Coop can be set up by qualified majority, it is hard to imagine that such a move would actually be undertaken against the explicit opposition of other member states.

A final aspect of PS Coop requiring clarification is the role of the EDA. While the Lisbon Treaty calls upon the Agency to “contribute to the regular assessment of participating Member States’ contributions with regard to capabilities”, it fails to spell out how this ought to be done. Given that the member states make up its governing board, it will be interesting to see how EDA will proceed with this sensitive issue. Who will develop assessment criteria? Will they be listed and become auditable? If EDA is to emit recommendations, how can it make sure that member states take them into account? The issue seems even more complex since EDA and some member states pursue a capability-based approach to defence planning, whereas other member states continue to apply a threat-based one. This could generate assessment results that are not comparable.

### 3 THE IMPACT OF THE FINANCIAL CRISIS ON EU MEMBER STATES' DEFENCE SECTOR AND INTERMEDIATE OUTCOMES

This chapter evaluates the effects of the financial crisis on the defence sectors at national and EU levels. It offers a synthesis of the convergence and divergence in trends across the EU. The prime interest lies in identifying whether and how these may represent risks or opportunities for the EU Member States' Defence Sector and the future of CSDP.

#### 3.1 Strategic impact: Short and long term effects of the financial crisis on public budgets

The EU may be at the beginning of two decades of austerity for public budgets. The accumulated debts pose a long-term problem and growing risk for the EU economies. It can be assumed that current budgetary constraints for EU governments will persist at least until 2030. At least 1% of GDP per year or more would have to be invested to put debt levels on a firm downward path over the coming two decades.

Although a majority of EU MS is affected, effects and reactions differ: the extent to which consolidation of national budgets has been prioritized is a matter of national traditions in economic policy. Despite observable differences a majority of states has been affected by the crisis and has decided on major consolidation measures.

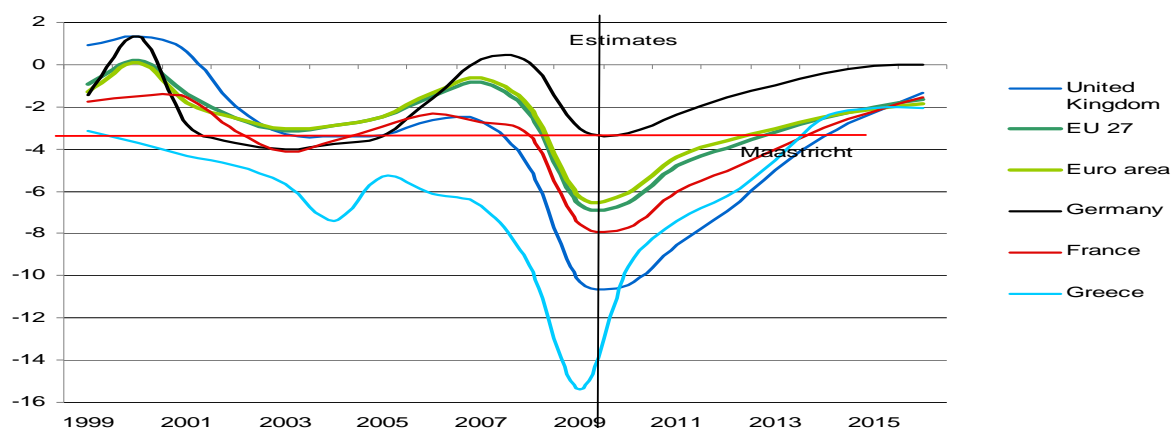
With the exception of Sweden, Poland, France, Finland and Denmark, all states are implementing more or less drastic consolidation measures strongly affecting defence spending. However, those who currently wall fence their defence budget cannot circumvent the growing pressure over the next years. While the EU currently debates and experiences the short term consequences of the financial crisis, the long-term effects are still ahead of the Union's public budgets.

#### Macro economic impact: two decades of austerity

The financial crisis hit the EU in 2008, creating two related problems. It forced the EU Member states to increase their public debt. As an immediate response, almost all member states had to lend money to ensure national recovery. This has increased public debt significantly. This alone sets a risk for the financial stability of the EU.

#### General government net lending/borrowing

Percent of GDP

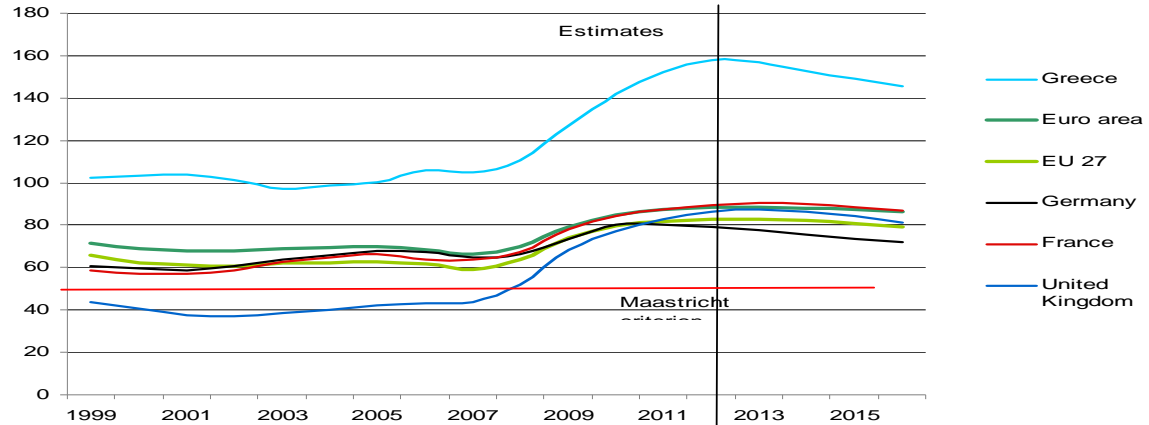


Source: International Monetary Fund, World Economic Outlook Database, April 2011

However, the crisis continues to impact. It forces the EU also in future to borrow money. Even if estimates show that the Maastricht criteria for annual debt could be kept from 2014 onwards, the level of gross debt is likely to remain above the pre-crisis times for the next two decades.<sup>17</sup>

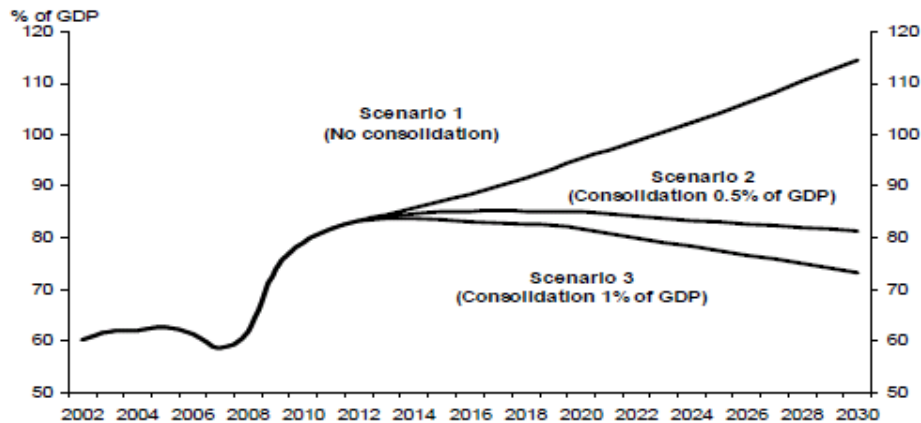
### General government gross debt

Percent of GDP



Source: International Monetary Fund, World Economic Outlook Database, April 2011

Moreover, while the economy shows first signs of recovery, these debts pose a long-term problem and keep up the risk for the EU economies and their political systems as a whole. Reducing public debt is without alternative in order to reduce this risk. Public spending will have to decrease. It can be assumed that the current budgetary constraints EU governments find themselves in will persist at least until 2030 (see graph below).<sup>18</sup> Given the forecasted demographic development a further strain will be put on public finances by the requirements of an ageing population.<sup>19</sup> As a consequence governments will be hard-pressed to find ways to reduce their expenditures in other areas. It can be assumed that the overall size of government budgets will be constrained and that any significant rise for particular budget items will come from reductions in other parts of the budget.<sup>20</sup>



Source: EU Commission: annual growth survey. Macro Economic report Annex 2 Brussels, 12.1.2011 COM (2011) 11 final.

<sup>17</sup> See also: Flanagan, S.J., A Diminishing Transatlantic Partnership? The Impact of the financial crisis on the European Defense and Foreign Assistance Capabilities, CSIS Report, Washington, May 2011.

<sup>18</sup> EU Commission: annual growth survey. Macro Economic report Annex 2 Brussels, 12.1.2011 COM(2011) 11 final.

<sup>19</sup> For details see DAS (2008). Geostrategic perspectives for the next thirty years. Report made under the direction of the Délégation aux affaires stratégiques. Paris, Délégation aux affaires stratégiques.

<sup>20</sup> SANDERA: The future impact of Security and Defence policies on the European Research Area – Report on Policy implications, to be published May 2011



According to the EU Commission, explaining the graph above:<sup>21</sup> "...simulations indicate that an annual improvement of the structural budget balance of 0.5% of GDP - the conventional benchmark under the provisions of the Stability and Growth Pact (SGP) - would clearly be insufficient in many EU Member States to bring the debt to GDP ratio close to the Treaty-based threshold of 60% of GDP in the foreseeable future (see Graph above). Only fiscal corrections of 1% of GDP per year or more would put debt levels in percent of GDP on a firm downward path over the coming two decades. However, fiscal consolidation, while absolutely necessary, might not always be sufficient to reverse adverse debt dynamics quickly and durably. Stronger output growth is imperative to increase fiscal revenue and lower unemployment-related expenditures, while automatically reducing the level of debt expressed as a share of GDP... As a result, fiscal policy makers in the EU face a formidable double challenge: putting fiscal policy back on a sustainable path while protecting or supporting short-run economic growth and employment. Under current circumstances, there is reason to believe that getting public finances in order will have a positive impact on economic growth in the medium run. Delaying fiscal adjustment would only push out and compound the problem. It would seriously compromise our ability to actively shape our future, and heavily mortgage future generations."

### **Diverging effects among the EU member states**

Despite observable differences a majority of states has been affected by the crisis and has decided on major consolidation measures. With the exception of Sweden, Poland, France, Finland and Denmark, all states are implementing more or less drastic consolidations measures strongly affecting defence spending. Still, no unified European response to the financial pressure has emerged.

Each member state has first and foremost been dealing with the necessary fiscal adaptations at national level, most states having adopted savings plans for the period 2010-2013 or 2011-2014. Taking a closer look at the individual EU states, the extent to which consolidation of national budgets has been stringently prioritized is a matter of national traditions in economic policy. Keynesian economies such as France or Italy are used to run larger national deficits than others and have thus been more lenient with regard to savings than others, such as the UK or Germany.

### **3.2 From savings imperatives to defence cuts**

The impact of the budget pressure on the EU member states' defence apparatuses differs significantly. This diversity results especially from different degrees of importance attributed to defence.

While significant cuts in defence budgets are planned or under the way in Germany and the UK, but also in a number of middle sized and smaller states others like Poland and Sweden record growing defence budgets. Most dramatic cuts of all are to be found amongst the small EU-member states, with rates above 30%. The majority of middle-sized states implemented average cuts of 10% in their defence budgets. Among the bigger EU countries under pressure, there seems to be most political and economic room for manoeuvre.

The impact of the financial crisis on the EU-27 individual defence apparatuses is quite diverse. Effects came with some delay in the defence budgets from 2009 onwards. At one extreme, one currently finds significant cuts in defence budgets such as in Germany and the UK, but also in a number of middle sized and smaller states. At the other extreme, some states record steady (Finland, Denmark) or even growing defence budgets (Poland, Sweden).

This diversity results chiefly from different degrees of importance attributed to defence. The extent to which defence budgets had or have to pay their due to national consolidation efforts depends largely on the place and value attributed to defence as expression of national identity. Some heavily affected member states, such as Finland and Denmark, for instance, decided to keep defence budgets steady.

<sup>21</sup> Source: EU Commission: annual growth survey. Macro Economic report Annex 2 Brussels, 12.1.2011 COM(2011) 11 final.

States such as France or Italy have been strongly affected by the crisis, but the consolidation packages in the defence sectors do not quite reflect a degree of fiscal urgency.

Most of the bigger EU countries are under pressure to consolidate their national budgets. However, the extent to which this affects the defence budget is a political decision. Moreover, even in those cases the Treasuries imposed saving imperatives on MoDs, they are not necessarily being prepared and implemented immediately, like in the case of Germany.

The British defence budget that had already been under considerable strain will now be confronted with an additional 8% cut between 2011 and 2014. These 8% cuts are significant because possible savings have been realized through earlier rounds of defence spending cuts. In Germany, no concrete road-map has been defined to implement the savings of €8.3bn required by the Finance Minister of the MoD and the armed forces between 2011 and 2014 to comply with the national debt ceiling. Cuts in Spanish defence spending started in 2009 with the first decrease in the defence budget by 3% in ten years. Additional 6.2% cuts were made in the 2010 budget. A national consolidation package of €15bn was adopted that same year. The defence budget for 2011 is forecasted to suffer an additional 7% cut in comparison to the previous year.

The French government comparatively spared its MoD, despite being strongly affected by the global recession: Declared savings for the period 2011-2013 amount to roughly €3.5bn and the national defence industry has benefited from a stimulus package for armaments of around €2.3bn for 2009 and 2010 and a boost in national demand to keep up certain lines of production (Rafale, BPC Dismude). The Italian Finance Ministry has imposed 10% budget cuts for all Ministries over the timeframe 2010-2011. However, after a dip of about 4.5% in the defence budget for 2009, the budget request for 2011 shows a slight increase of 0.5% in comparison to the base budget of 2010.

The Swedish government has barely been affected by the crisis and has gone on with its planned reform agenda with no planned cuts in procurement and modernization. Whilst the core defence spending is kept flat between 2010 and 2011, a supplement of €4.8bn p.a. between 2010 and 2015 has been adopted to cover modernization expenses. The Polish defence budget suffered cuts of 20% in 2009 but has since then been marked by a healthy recovery with no reductions in 2010 and an unexpected rise by 7.1% in 2011, including a 16% increase in investment spending.

Most middle-sized states implemented average cuts of 10% in their defence budgets. Yet some did so over a one-year-period (e.g. the Czech Republic for 2011, Ireland for 2010, 11% for Portugal in 2010) and others over a two-year period (e.g. Belgium from 2009 to 2011). The most important cuts in this category were experienced in Greece (-18% in 2010 and -19% in 2011) and Romania (-17%). Bulgaria started with 38% cuts in its budget in 2010, but found this budgetary situation untenable due to foregone contracts and compensated the budget. Whilst Denmark and Finland were the most affected countries in the Nordic/Scandinavian region, they resisted too significant defence cuts, opting instead for modest increases over the coming years, while seeking greater efficiency in their military apparatuses.

The most dramatic cuts of all are to be found amongst the small EU-member states. Latvia implemented a 21% cut in its 2009 budget, whilst Lithuania had to implement a 36% cut in its 2010 budget. Cyprus' budget has slightly increased. Information on Luxembourg, Malta, Slovenia and Slovakia is currently not available.



### 3.3 Problems and Measures imposed on the Defence Sector in the Wake of the Crisis

In those states deciding to implement defence-related cuts, the decision how to distribute savings across the defence apparatus has varied. The most significant differences relate to the decision whether to privilege the modernization of equipment and R&T over end-strength or not.

**Level of Ambition (LoA):** Until today only the UK has changed its LoA, but Germany might follow soon. But on the general LoA among EU still shows the same distribution as before the crisis: A key interest shared among almost all EU member states is to enhance the sustainable deployability of the armed forces in distant theatres. Additionally, the bigger EU countries aim to maintain *full-spectrum forces*. On the lower end, middle-sized and small member-states aim to offer *niche capabilities* in future and work towards role specialization.

**Personnel:** majority of EU states struggles with personnel costs due to overblown bureaucratic structures in their Defence Ministries and top-heavy armed services with too large a proportion of high-grade, high-income militaries. Cuts in wages or pay freezes are common as well as reducing civilian personnel. Some states seem to have decided on cuts in military end-strength. However, reducing personnel costs may clash either with long-term contracts or with already streamlined forces, where further reductions would directly hit capabilities and the ability to contribute to NATO and EU operations. The latter situation holds particularly true for the UK and Sweden. Regularly, the most expensive soldiers or civilians can be found in the upper rungs, being public servants. Hence, reducing their impact on the budget would require additional resources for golden handshakes, or other forms of compensation.

**Armaments:** Generally, cuts in the area of procurement planned or realized reached a much lower level across EU member states than discussed at the beginning of national response plans. However, due to very diverse reactions the risk of a growing gap between “modernizers” and “procurement cutters” increases. Slaying such projects endangers modernisation and is often not a practicable solution, as many states are bound to these projects by long-term contracts. Cancellation of contracts often incurs costs through penalty clauses comparable to the original costs for the equipment. Besides, they have to factor in the effects lower investments in defence procurement will have for their defence contractors. Hence, especially bigger member states and those with considerable a defence industry, have decided to keep their procurement contracts. But almost all countries aim to either delay the programme output or to reduce the quantities to be purchased. Some medium-sized and small states decided to postpone decisions on the modernization of key conventional capabilities whilst others clearly prioritized the modernization of such capabilities.

**Operation and Maintenance:** Most large member states and an important segment of medium-sized states accelerated the decommissioning of older capabilities. One noteworthy trend in reactions to the financial pressures is the cuts in which has gone hand in hand with an increased interest in using simulators for training, outsourcing training to private firms.

**International Engagement:** Despite strong pressures on the defence budgets, almost no member state has to date opted for a withdrawal from ongoing military engagements. However, most member states did reduce the number of troops in certain missions and/or shift their weight across their multiple engagements. With no exception, these shifts occurred to the advantage of the ISAF-mission in Afghanistan.

The EU-based defence industries have not been seriously affected by the crisis so far. But a long-term fiscal downturn may imply serious programme cuts, market shrinkages or delays for new programmes lying ahead for almost all EU member states. While the demand may lower, it will come along with increased value-for-money imperatives. This may turn into additional arguments for EU-based companies to further develop footholds in the US and emerging markets like Asia and South America. Member states with significant defence industry have reacted quite differently so far – in line with their traditional approach to defence industrial policy. Cross national coordination has only taken place to some extend among France and the UK. The main objective is to consolidate or protect national assets.

## Armed Forces: Three Levels of Ambition and the Impact of the Financial Crisis

The impact of the crisis on the military coincides with the implementation of already established reform processes. It may well change the existing levels of ambition (LoA) of individual member states. These can currently be divided into three levels of ambition:

- A key interest shared among almost all EU member states is to enhance the sustainable deployability of the armed forces in distant theatres.
- Additionally, the bigger EU countries aim to maintain *full-spectrum forces*.
- *On the lower end*, middle-sized and small member-states aim to offer *niche capabilities* in future and work towards role specialization.

Almost all EU member states are still re-shaping their national armed forces from territorial defence into expeditionary tasks. Despite consistent downsizing efforts since the early 1990s, most big and middle-sized member states started their more serious overhaul efforts between 1999 and 2001. Another wave of reforms started between 2004 and 2006. The financial crisis may add further pressure on the downsizing of national levels of ambition that are part of a shift of the armed forces from a posture of territorial defence to force projection. It may also imply to rethink the ability to deliver necessary capabilities through multinational efforts. So far, only the UK has lowered its LoA officially, however German plans are heading into the same direction.

All bigger EU Countries aim to maintain *full-spectrum forces*, as well as Portugal and Bulgaria. They want to be able to engage in high-intensity scenarios, i.e. conventional state-to-state warfare, as much as in stability and peace operations. Even Sweden has re-focused on conventional capabilities since the incidents in Georgia in 2008. In these cases, the financial crisis looms large. It remains questionable to what extent a critical quantity of conventional full-spectrum capabilities can be sustained nationally by small forces, given that these are most the expensive capabilities.

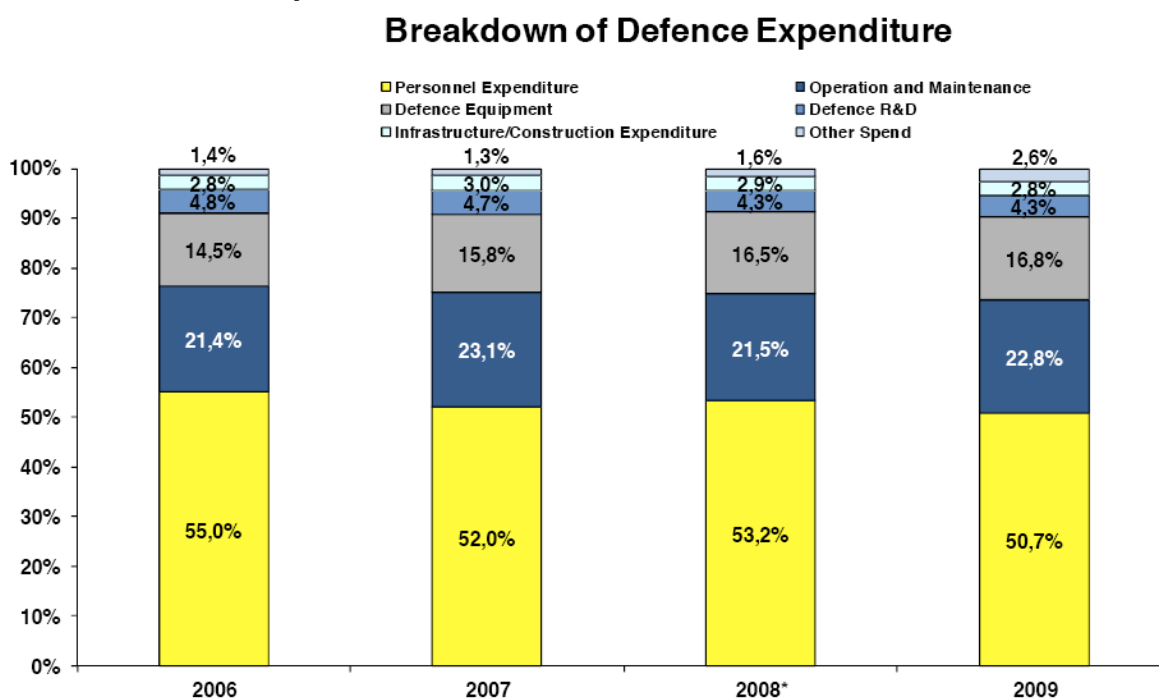
A large majority of middle-sized states are shifting their capability balance towards those needed in *multilateral stability operations*, even though territorial defence is of course not fully abandoned in national defence postures. Finland and Greece are two noteworthy exceptions to this main trend, as both are still almost exclusively focused on guaranteeing territorial defence and maintaining adequate capabilities: Finland focuses on the perceived threat emanating from Russia. Greece pays its due to a long-held rivalry with Turkey through exorbitant defence expenses in conventional capabilities.

A number of middle-sized and small member-states explicitly aim to offer *niche capabilities* and work with other smaller states towards a role specialization. These countries are not able or willing to maintain armed forces covering the entire spectrum of conflict anymore. Belgium maintains niche capabilities for conventional conflict (combat aircraft, special forces, frigates and mine-hunters); the Czech Republic focuses on NBC protection, MedEvac and electronic warfare; Romania is building up niche capabilities in the special operations sector in cooperation with the United States; Hungary is starting to draw up options for specialization, including a focus on NBC protection and favouring cooperative role-specialisation with smaller nations such as Austria, Slovenia, Finland and Belgium. Luxemburg specializes in reconnaissance and Latvia in medical response, military police and engineering support. Cyprus and Slovakia have expressed an interest in identifying options for specialisation but haven't yet done so.

## Personnel Expenditure: difficult to shrink

Personnel expenditure accounts for more than 50% of the EU member states defence budgets. Italy, Bulgaria and Romania represent extremes in this respect, as they spend between 70% and 80% of their defence budget on personnel costs. On top of 1.6 mio soldiers, more than 400,000 civilian personnel work in EU defence ministries.<sup>22</sup>

### Breakdown of Defence Expenditure



Source: EDA: Additional Defence Data 2009, Brussels 2011

A large majority of EU states struggles with personnel costs due to overblown bureaucratic structures in their Defence Ministries and top-heavy armed services with too large a proportion of high-grade, high-income militaries.

However, reducing personnel costs may clash either with long-term contracts or with already streamlined forces, where further reductions would directly hit capabilities and the ability to contribute to NATO and EU operations. The latter situation holds particularly true for the UK and Sweden. Regularly, the most expensive soldiers or civilians can be found in the upper rungs, being public servants. Hence, reducing their impact on the budget would require additional resources for golden handshakes, or other forms of compensation. Moreover, these people are needed to implement defence reforms, as they often have blocking power within the defence bureaucracies. While defence reforms have already led to leaner personnel structures, reduced end-strength, and increased deployability, they have not been able to replace this type of personnel.

Current efforts to cut personnel costs due to the savings imperative mount up to 20 % (Bulgaria) or even 30% (Netherlands) over the coming years. Efforts take different forms: Cuts in wages or pay freezes are common, notably in Spain, the Czech Republic, Greece, Portugal and Lithuania. Reducing civilian personnel is an option favoured by the majority of member states. Some states seem to have decided on cuts in military end-strength (Italy, Austria, and Belgium).

In France, drastic cuts in personnel as part of ongoing reform plans have already been on the agenda since 2008. The UK has had already implemented significant cuts. Therefore recently decided reduction

<sup>22</sup> EDA: Additional Defence Data 2009, Brussels 2011; Denmark has been left out, as it is no participating member state of EDA

of military personnel will hit directly the capability as almost all buffers have been melted down. In Germany, ongoing reform plans of the *Bundeswehr* also involve cuts in end-strength of about 25% to around 185,000. As this will mainly be achieved by scraping conscription, turning the *Bundeswehr* into a professional army will induce extra costs. Despite initial declarations that no crisis induced structural changes were foreseen, the Spanish government recently announced cuts of up to 6,000 jobs and significant cuts of almost 40% with regard to the armed forces' modernization until 2013. Despite a comparatively relaxed fiscal situation, Poland engages in an overhaul of the MoD's spending structure by reducing personnel-related expenses through civilian job cuts of up to 10% and additional cuts in the military by 2012. No cuts in defence-related personnel are planned in Sweden thanks to a comfortable financial situation.

### **Armaments: potential gap between modernizers and procurement cutters**

As a first reflex, many countries sought to cut the costs of procurement contracts and armament projects. This may slow down or endanger modernisation and is often not a practicable solution, as many states are bound to these projects by long-term contracts. Cancellation of contracts often incurs costs through penalty clauses comparable to the original costs for the equipment. Besides, they have to factor in the effects lower investments in defence procurement will have for their defence contractors.

Resulting from this mixture of motivations cuts have been realized to a much lower level than discussed at the beginning of national response plans. Still, ongoing debate and decision fuels the risk of a growing gap between "modernizers" and "procurement cutters" at the EU level. Especially bigger member states have decided to keep their procurement contracts. But almost all countries aim to either delay the programme output or to reduce the quantities to be purchased. Some medium-sized and small states decided to postpone decisions on the modernization of key conventional capabilities (esp. multi role combat aircraft, such as the replacements of F-16s for Denmark), whilst others clearly prioritized the modernization of such capabilities (Portugal decided to keep up the modernization of the Air Force while cutting the modernization budget of its land forces by 40% p.a. until 2013, Finland decided on the mid-life upgrade of its F-18s).

A number of cuts in modernization efforts and procurement are almost certain in France, although sectors such as deterrence and ISR will be preserved no matter what. In Germany, cuts and postponement in procurement have not been coordinated enough to effectively contribute towards the needed amount of savings. In Poland, administrative reform and cuts in end-strength go hand in hand with prioritizing expenses for the modernization of the armed forces. Sweden is in a similarly comfortable situation: Supplementary allocations for the period 2010-2015 will boost the reform of the armed forces and for equipment in particular.

Much like France, Italy protects its domestic defence industry through increases in the investment part of the defence budget. The Ministry of the Economy, for instance, still provides a large share of national procurement money that is not accounted for as defence-related expenses. Furthermore, Italy prioritizes modernization of equipment and in turn tolerates additional cuts in end-strength not foreseen by initial reform plans to compensate.

Programmes spared from cuts were mostly of direct relevance to ongoing military missions (strategic and tactical airlift capabilities, SAR, CSAR, UAVs, armoured vehicles). Other states, such as Denmark and the Netherlands, however, decided to cancel a programme such as NATO's Allied Ground System despite its transatlantic relevance and left uncertainty as to future orders of the Joint Strike Fighter beyond a continued commitment to financing its development and testing phase.

## **Operation & Maintenance: Decommissioning Old Equipment**

Most large member states and an important segment of medium-sized states accelerated the decommissioning of older capabilities (e.g. UK, Portugal, France, Germany, Austria, Czech Republic, Denmark, Finland, and the Netherlands). Most of them (e.g. Portugal, France, Germany, and Austria) try to re-sell them on the European and extra-European markets. How to deal with ongoing acquisition programmes already under contract, such as the A400M or the Eurofighter remained a politically very delicate topic. Germany and Italy decided to re-sell the tranche 3b of the Eurofighter on the international market, begging the question of a coordinated approach to exports lest a downward bidding-spiral results. A similar situation arises with regard to excess A 400M ordered to bolster this European project.

One noteworthy trend in reactions to the financial pressures is the cuts in training made in many states,<sup>23</sup> which have gone hand in hand with an increased interest in using simulators for training, outsourcing training to private firms (Finland, but also Sweden) and most importantly in cooperating with European partners on joint training (Belgium) and on using training simulators multinationally (Germany, Austria).

## **International Engagement: no cuts but shifting priorities**

Despite strong pressures on the defence budgets, almost no member state has to date opted for a precipitated withdrawal from ongoing military engagements, with the exception of Greece and Ireland. Some, like Portugal, opted for an even diminution of all military contributions. The Netherlands had to withdraw from Afghanistan due to domestic disagreements over the prolongation of the mandate in 2010 and less out of sheer economic reasons.

However, most member states did reduce the number of troops in certain missions and/or shift their weight across their multiple engagements. With no exception, these shifts occurred to the advantage of the ISAF-mission in Afghanistan.<sup>24</sup> The decision to withdraw troops was mostly made with regard to Kosovo and the Balkans, and was made in light of a reappraisal of the security situation. The UK is so far the only state that has explicitly lowered its level of ambition as a consequence of its Strategic Defence and Security Review in 2010.

## **Delayed consequences for the defence industry?<sup>25</sup>**

To date the European defence industrial base is not seriously affected by the crisis. However, this may change soon. Prime contractors either haven't been hit by the crisis or are recovering rather quickly. But the fiscal downturn may imply serious programme cuts, shrinkages or delays lying ahead for almost all EU member states. These are likely to impact on industry more seriously in the years ahead and result in stronger competition for contracts within a lower-demand environment and increased value-for-money imperatives.

Beyond the crisis, to the industry, the lacking consolidation of demand within the EU represents a major challenge: Firms are increasingly interested in consolidating their foothold in the US, or in developing cooperation with emergent countries. For global defence firms future markets are not found in Europe. Hence we see first shifts of production lines towards Asia and South America. Research and Development entities of European Firms may follow. Firms such as Rheinmetall or EADS-Cassidian also re-weighted their business models to abandon certain defence-related production lines to concentrate on civil security (e.g. border control, airport security).

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<sup>23</sup> A-Countries (Italy, Spain), B-Countries (Greece, Netherlands, Portugal, Czech Republic), C-Countries (Lithuania).

<sup>24</sup> A-Countries (Italy, Poland, Spain); B-Countries (Bulgaria, Czech Republic); Slovakia and Hungary increased troop participation to ISAF without any reductions elsewhere.

<sup>25</sup> This section draws on Sophie C. Brune, Alastair Cameron, Jean-Pierre Maulny, Marcin Terlikowski, Restructuring Europe's Armed Forces in Times of Austerity, SWP-Working Paper No.8, November 2010.

Member states with significant defence industry have reacted quite differently so far – in line with their traditional approach to defence industrial policy. Cross national coordination has only taken place to some extent among France and the UK. The main objective is to consolidate or protect national assets.

The British defence industry is exposed to shrinking national demand. However a prime Contractor such as BAE Systems has developed a business model based on the diversification of the products and services it offers, which makes it less reliant on the UK customer base. This resulted from a substantial restructuring of the UK defence industry over the 1990s: By driving down costs and pursuing diversification into the dual-use and security sector, British industry has become highly competitive at home and abroad.

French defence exports have been stagnating since the beginning of the decade, despite growth in global demand. For the past three years, the French government has been trying to improve the French defence industry's export performance. Meanwhile, it seeks to find the necessary funds to maintain the production lines of the Rafale jet and to offset lacking export demand for the model. The government seeks to further the consolidation of certain segments of national champions, whilst pushing for the diversification of their activities in the wider sector of security (Thales and Sagem).

In Germany, economic data available on the reaction of individual defence firms like Rheinmetall, EADS, OHB and Diehl seems to paint a mitigated picture: Most firms are starting to show clear signs of recovery from the peak of the crisis in 2008-2009, partly due to recent government efforts to improve acquisition for ongoing deployments, and to dual-use and non-defence related activities. Both the national defence industry association and the labour union call on the government to help secure the national industrial basis (core capacities) through targeted national orders and through the shortening of administrative delays for exporting defence goods.

In Poland, an industry strategy was adopted by government prior to the crisis that involves further consolidation within the Bumar group, recapitalization as well as concentration on core business (e.g. track and wheeled armoured platforms, munitions, opto-electronics, radars). Yet, the 2009 defence cuts hit those firms severely, since they are almost entirely dependent on the Polish MOD procurements and exports being only a periodic source of revenue. Special financial instruments, mainly governmental guarantees and credits, were needed to save a couple of Bumar companies suddenly on the verge of bankruptcy. Nonetheless, Bumar progressively seeks to increase its export-revenues.

### **3.4 Existing and Emerging Geometries of Cooperation**

Currently, defence cooperation undergoes a revival. Especially the rather long-existing cooperation forms of Pooling & Sharing receive renewed interest. This has to be seen on the one hand against long existing landscape of cooperation among EU countries, be it in bi- and multinational frames or linked to the EU. On the other hand, this existing and envisaged cooperation is still more the exception than the rule. Out of 1.6 million Soldiers in the EU only a few thousand are organized in formations like Eurocorps or EU-Battlegroups.<sup>26</sup>

A lot of factors have to align for pooling and other forms of partnerships to succeed. Pan-EU cooperation will certainly remain the exception rather than the rule. What can be achieved, however, is to establish a link between cooperative geometries sharing similar motivations to foster a degree of coordination among efforts in order not to foreclose efforts that could benefit CSDP in the long run. Obstacles to and progress in integration or cooperation will vary from one cluster to the other. This fact calls for a differentiated analysis of the problems and opportunities inherent to every cluster.

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<sup>26</sup> Tomas Valasek: Surviving austerity. The case for a new approach to EU military collaboration. CER-report, London 2011: 11



## Characteristics of existing Pooling & Sharing initiatives<sup>27</sup>

Analyzed existing examples for Pooling & Sharing show the wide spectrum of forms and areas of application international cooperation can take. What items and services can be subject to P&S and what has to be kept purely nationally varies greatly among member states. They typically build around user groups for equipment or specific capability shortfalls. While they build on existing patterns of cooperation among EU member states, the majority is not integrated in the EU framework, with the exception of EU-Battlegroups. Some of the larger P&S examples were developed within NATO context. This may indicate the need for strong political leadership. The majority of analysed Pooling & Sharing initiatives comprise five or less participants. While some of the cases exist since decades, their added value has been analysed scarcely.

Pooling & Sharing can improve the economies of scale of armed forces through international cooperation. It can take place in almost every phase of an equipment life cycle. The demand for a helicopter can be pooled, but also the acquisition and the maintenance. Similarly, areas related to armed forces especially in the domain of services like training or logistics can be subject to pooling and sharing. The methods to achieve pooling and sharing can vary. They can be combined to comprise for example outsourcing or pooling of demand for acquisition through joint biddings or tenders.

Pooling and sharing can be divided into four types:<sup>28</sup>

- **Sharing of capabilities:** member states create common capabilities by providing national capabilities. There is no structure to organize their use. One example is the NATO air policing in the Baltic countries.
- **Pooling of capabilities:** Member states provide national capabilities. In addition, they set up a structure to organize the use of these national capabilities: the most concrete examples are the European Air Transport Command (EATC) and EU-Battlegroups.
- **Pooling through joint acquisition:** national capabilities do not exist or become redeemed by multilateral capabilities. A multilateral organization owns the assets. This is the case with NATO AWACS.
- **Role and task sharing:** certain capabilities or equipment are relinquished because another country will make them available. One example is the takeover of the Dutch Maritime Patrol Aircraft by the Bundeswehr.

A rough survey of about 70 cooperation programmes indicates that EU member states are involved in a number of Pooling and Sharing projects. They may allow drawing some initial lessons and conclusions. The sample shows that the scope for pooling and sharing so far covers a wide spectrum of military capabilities. Instead of a one size fits all solution several business models are developed among partners involved.

What can be subject to P&S and what has to be kept purely nationally varies greatly among member states. The two extremes can be described by non-recurring initiatives for training or logistic support at the lower end and pooled capabilities such as EU Battlegroups, the South Eastern Europe Brigade or the Belgian-Dutch F-16 Expeditionary wing at the high end of the spectrum. The latter two have been used for operations.

Besides a group of individually motivated initiatives, P&S initiatives show several characteristics: They are either “User Groups” based on common equipment or they respond to a specific capability shortfall, like AWACS, AGS, SALIS etc. and are mostly undertaken between Member States with pre-existing

<sup>27</sup> This chapter bases on a survey carried out by SWP as well as on briefings by EU-institution Officials under Chatham House Rule.

<sup>28</sup> Jean-Pierre Maulny, Fabio Liberti : Pooling of EU Member State assets in the implementation of ESDP. Study for the European Parliament's Subcommittee on Security and Defence, February 2008



patterns of cooperation. In particular there are clusters of regional co-operation. However only the EU-Battlegroups are an EU-unique development under the CSDP framework. Some of the larger P&S examples were developed within NATO context. This may indicate the need for strong political leadership. The P&S communities are often small groupings. Sixty percent of all projects consist of up to 5 participants. The most frequent grouping is bilateral co-operation - about 20% of all projects.

Benefits have been scarcely analysed to date.<sup>29</sup> Member States believe that these projects have delivered economies of scale. They have improved efficiency: capabilities being provided with fewer resources or certain capabilities only being retained through such collaboration. Last but not least they may have supported interoperability etc.

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<sup>29</sup> Helpful insights can also be found in : Darnis, J-P et al , Lessons from European Defence Procurement Programmes, EU ISS, Occassional Paper 69, Paris, October 2007

Multinational Military Cooperation in Europe																												
Name	Germany	France	United Kingdom	Italy	Portugal	Greece	Poland	Czech Republic	Sweden	Denmark	Austria	Norway	Hungary	Finland	Estonia	Bulgaria	Latvia	Lithuania	Luxembourg	Netherlands	Belgium	Romania	Slovakia	Slovenia	Cyprus	Turkey	Area	
NLSE: NATO Logistic Stock Exchange	X	X	X	X	X	X	X	X		X	X		X						X	X						X	Maintenance, Supply & Logistics	
Euro-NATO Joint Jet Pilot Training	X	X	X	X	X	X				X									X	X						X	Training & Education	
TLP: Tactical Leadership Programme	X	X	X	X	X		X			X									X	X							Training & Education	
MCCE: movement Coordination Center Europe	X	X	X	X	X	X		X	X	X	X	X	X	X	X		X		X	X	X	X		X		X	Transport	
RDCs: The Rapid Deployable Corps	X	X	X	X	X	X	X								X							X	X		X	Operational Capability & Command		
Alliance Ground Surveillance	X			X			X		X	X				X	X	X	X	X				X	X	X			Surveillance & information	
NATO SEASPARROW Surface Missile System	X		X		X	X			X	X									X	X						X	Operational Capability & Command	
Strategic Airlift Capability						X	X			X	X	X	X	X	X		X		X	X	X	X	X				Maintenance, Supply & Logistics	
Strategic Airlift Interim Solution (SALIS)	X	X	X			X	X	X	X	X	X	X	X					X	X	X		X	X	X			Maintenance, Supply & Logistics	
AWACS	X	X		X	X	X	X	X		X		X						X	X	X						X	Operational Capability & Command	
ATARES: Air transport and Air to Air Refueling Exchange of Services	X	X	X	X	X		X		X	X		X							X	X							Transport	
Joint CBRN Defence Centre of Excellence	X		X		X		X		X														X	X	X		Training & Education	
EATC: European Air Transport Command	X	X																	X	X							Transport	
MLCC: Multinational Logistics Coordination Center			X			X		X				X															Maintenance, Supply & Logistics	
EATF: European Air Transport Fleet	X	X		X	X	X	X	X	X				X					X	X	X		X					Transport	
Helios		X		X	X	X														X							Surveillance & information	
Helios2 / COSMO		X		X																							Surveillance & information	
Helios2 / SAR	X	X																									Surveillance & information	
MSSC: Multinational Sealift Coordination Centre				X	X	X	X	X			X											X	X	X	X		Maintenance, Supply & Logistics	
EU FHQ: Force Head Quarters	X	X		X																							Operational Capability & Command	
EUROFOR		X		X	X	X																					Operational Capability & Command	
SEEB: South Eastern Europe Brigade				X		X									X								X			X	Operational Capability & Command	
EU Battlegroups	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	Operational Capability & Command	
SIAF: Spanish-Italian Amphibious Force				X	X	X																					Operational Capability & Command	
EURMARFOR: European Maritime Force		X	X	X	X																						Operational Capability & Command	
AWTI: Air Weapons Trainings Installation	X			X																							Training & Education	
HQJ Corps	X	X	X	X	X		X		X	X									X	X							Operational Capability & Command	
UK-NL Amphibious Force			X																X								Operational Capability & Command	
BENSAM: Belgium-Netherlands Naval Cooperation																			X	X							Training Education, Control & Command, Logistik	
NLSP: The Naval Logistics Support Partnership				X	X	X	X	X		X										X					X		Maintenance, Supply & Logistics	
MarSur: Maritime Surveillance Network		X	X	X	X			X				X															Surveillance & information	
MLF: Multinational Land Force				X							X													X			Operational Capability & Command	
Sea Surveillance Co-operation Finland-Sweden								X					X														Control & Command, Information	
ARCHER: Common acquisition of artillery system								X				X															Armaments	
BALTRON: The Baltic Naval Squadron														X		X	X										Operational Capability & Command	
Baltic Defence College:														X		X	X										Training & Education	
Cooperation between BE and NL Navy																			X	X							Operational Capability & Command	
Cooperation between BE and FR on Pilot training		X																		X							Training & Education	
F 16 Expeditionary Air Wing					X				X	X									X	X	X						Operational Capability & Command	
Rolls Royce Spey Gas Turbine			X		X															X	X						Armaments	
multi-purpose frigates M class					X															X	X						Operational Capability & Command	
Tripartite Minehunters		X																	X	X							Operational Capability & Command	
Pandor User Group					X			X		X										X			X				Maintenance, Supply & Logistics	
Dingo User Group	X						X			X								X	X								Maintenance, Supply & Logistics	
HELIDAX Helicopter Training		X																		X							Training & Education	
Multinational Sealift Steering Committee	X		X			X			X		X	X					X		X					X			Maintenance, Supply & Logistics	
MCG Multinational Civilian Military Cooperation Group					X	X	X				X												X				Operational Capability & Command	
Naval Helicopter NH 90	X	X			X	X													X	X							Maintenance, Supply & Logistics + Armaments	
HERCULES C-130J Joint User Group			X		X				X	X																	Maintenance, Supply & Logistics	
C27J Spartan Group				X		X									X		X						X				Maintenance, Supply & Logistics	
Gripen User Group								X	X			X															Maintenance, Supply & Logistics	
Common use Item System	X	X	X	X	X	X				X		X							X	X							Maintenance, Supply & Logistics	
Harpoon Joint Executive Committee	X					X	X			X									X								Maintenance, Supply & Logistics	
MK 46 Torpedo Weapon System Partnership				X	X	X																					Maintenance, Supply & Logistics	
French Portuguese Cooperation on Maritime Surveillance		X				X																					Surveillance & information	
Spanish Portuguese Coop on Maritime Surveillance				X		X																					Surveillance & information	
Greek Portuguese Naval Coop					X	X																					Surveillance & information	
Oto Melara Compact Gun Group	X			X		X	X			X		X							X	X						X	Maintenance, Supply & Logistics	
HTTP Helicopter Training Programme			X					X	X		X							X									Training & Education	
Exchange of classified Information								X	X		X		X														Surveillance & information	
Storage of special Artillery munitions								X					X														Maintenance, Supply & Logistics	
MCM Capabity								X	X		X		X														Operational Capability & Command	
Multi Purpose Gun								X					X														Armaments	
Baltic Naval Training Centres														X		X	X										Training & Education	
Baltic Air Surveillance Network and Control System														X		X	X										Surveillance & information	
Surface to Surface Missile	X						X	X					X														Armaments	
EDA joint investment programme	X	X		X	X	X	X	X	X	X	X	X	X	X	X				X	X		X	X	X	X		Armaments	

Source: SWP-own survey

## Characteristics of Emerging Clusters of Cooperation

The financial crisis has certainly boosted negotiations and initiatives for more international cooperation. Assessing the eight most prominent initiatives, EU member states can be divided into three groups according to their attitude towards this revival of cooperation initiatives: *Activists* are actively looking for cooperation options or leading efforts in this domain: France, Germany, Poland, Netherlands and Sweden. Belgium, Finland, Greece, Hungary and Bulgaria. *The Undecided* have an ambiguous stance regarding closer defence cooperation within the EU. They may favour e.g. the NATO framework or bilateral formats (French-British Agreement): the UK, Denmark, Italy, Spain, Portugal and Romania. *The Specialists* are a number of smaller states constrained by the proportionate burden a military imposes on a small national economy, interested in developing niche capabilities that would ultimately lead to some form of role specialization amongst the militarily smaller states in the EU.

However, entirely new initiatives, inspired by the financial crisis are only the Ghent Initiative and the Nordic pact. Often, current re-energizing builds on established relations at highest political levels or pre-existing cooperative frameworks, or both. These vary significantly regarding membership, objectives, stages of preparation and output. Moreover, not only multilateral but also bilateral cooperation became revisited, with the Franco-British pact being the most prominent example.

Hence, a complex framework of overlapping cooperation clusters currently unfolds. While their necessary mix for success is difficult to define some variables play an enabling role for these cooperations: regional proximity and similar geographic size; moreover strategic culture and pre-existing political cooperation but also palpable political interests have to align; defence industrial relations are likely to be supportive if they are asymmetrical, i.e. diverging industrial landscape that will not suffer from a cooperation induced rationalisation in the industrial sector.

Recently a debate about new bi- and multilateral cooperation in the area of defence has surfaced. We can identify eight different initiatives. These vary with regard to memberships, objectives and output.

It can be argued that the financial crisis has speed up negotiations and initiatives. However, entirely new initiatives, inspired by the financial crisis are only the Ghent Initiative and the Nordic pact. Especially the Franco-British pact builds upon a long history of joint plans for more cooperation in the area of defence. The current treaty has been prepared through long established relations at highest political levels. This pattern can be observed with respect to the other pre-existing cooperative frameworks: The Nordic Defence Cooperation framework, the Visegrad Four, the Weimar Triangle or the South Eastern Europe Defence Ministerial Process (SEDM) are being revisited with the aim to identify opportunities for joint savings.

The depth of cooperation varies greatly from region to region. Whilst NORDEFECO seems intent on working with concrete pooling and sharing options, efforts in the realm of the Visegrad Four or the SEDM remain only at preliminary stages. Cooperation within the NORDEFECO framework so far is the most elaborate cooperation effort integrating both capability planning and industrial aspects. Considering its already established links with the Baltic States and the interest manifested by Germany, the UK and Poland, it offers fertile ground for immediate pragmatic cooperative endeavours in pooling and sharing.

In addition to these multilateral efforts, a number of bilateral cooperation efforts by single states further blur the picture. A regional cluster such as NORDEFECO attracts and invites cooperation interest from Germany, Poland or the UK. The Baltic states are engaged in closer cooperative efforts with NORDEFECO, whilst they also engage in bilateral joint procurement agreements with Poland and Germany; Finland and Estonia entertain historically rooted close bilateral defence cooperation in joint procurement; Bulgaria expressed an interest in joining efforts with Romania on maintenance, crew training and air policing. Belgium and Luxemburg have in turn shown interest in cooperating with Germany and the Netherlands.

The cooperation maps thus emerging divides the EU into at least five interlinked cooperative clusters: The Nordic-Baltic cluster, the Leadership cluster (F-UK), the East-West cluster (Weimar Triangle), a 'New Europe' cluster (Visegrad Four) as well as a South-Eastern European cluster. Each tries to reach out to non-EU members in the immediate neighbourhood (Serbia, Bosnia etc.).

These regional cooperative clusters mostly aggregate because they are of similar size and/or share strategic cultures: The best examples are France and the UK that share similar defence political ambitions at international level due to their respective past as former Empire, or the shared historical past shared by the Scandinavian countries, Finland and the Baltic states.

Moreover, there has to be a palpable similar interest among the countries aggregating. The very visible impetus behind the French-British cooperation agreement or NORDEFCO arguably is to achieve savings. The formats with less concrete results and more political goals such as the Weimar Triangle, the Franco-German cooperation or the SEDM, seem to be pursuing more political goals such as furthering European integration or binding non-EU countries within a cooperative framework.

(Defence) industrial relations among cooperation partners also play a crucial role: Losses incurred as a result of reduced orders due to joint procurement implies the necessity for industrial losses to be evenly spread out across partners. In the long run, this fact potentially hampering cooperation begs the question of a European strategic defence industrial policy (see below).

A number of states have shown a novel or strengthened interest in the wake of the crisis for intensified cooperation in pooling and sharing capabilities or in using more intensively joint procurement opportunities where shared needs are evident. With regard to the interest shown for recent, crisis-induced initiatives such as the Ghent Process, EU member states can be divided into three groups according to their attitude:

- **Activists:** France, Germany, Poland Netherlands and Sweden are actively looking for cooperation options or leading efforts in this domain. Belgium, Finland, Greece, Hungary are following cooperative efforts or have declared a clear interest in pooling and sharing. Others, such as the Czech Republic (in favour of pooling air policing capabilities within NATO) or Bulgaria are beginning to show timid signs of interest.
- **Undecided:** The UK and Denmark have an ambiguous stance regarding closer defence cooperation within the EU, as they tend to favour cooperation through NATO or in a regional (NORDEFCO), if not bilateral format (French-British Agreement). Also states such as Italy, Spain, Portugal or Romania show limited interest and little engagement on the issue of pooling and sharing or role specialization.
- **Specialists:** A number of smaller states constrained by the proportionate burden a military impose on a small national economy—mostly small and medium sized countries—are interested in developing niche capabilities that would ultimately lead to some form of role specialization amongst the militarily smaller states in the EU.

#### *A      The Franco-British Defence pact: cooperation among military lead countries*

France and the United Kingdom have clearly opted in favour of a bilateral approach out of frustration with the intricacies of multilateral co-operation inside the EU. In the Declaration on Defence and Security Co-operation during the UK-France Summit on 2 November 2010, London and Paris identified a series of fields for deepening bilateral co-operation and sharing common defence equipment. London and Paris agreed to co-operate on nuclear testing. They also agreed to pool logistics and training for the A400M. France will use spare UK air-tanker capabilities, Research and technology co-operation will be continued with a joint annual budget of €100m. One essential caveat in the negotiations about pooling and sharing, however, is France's priority to secure its own political capacity to act. It is currently inconceivable to the French government to rely on the military capability of other states without a guarantee that those would be available to France to pursue priorities in national security policy

including French military operations abroad. This is why France has in the past months been engaging in a dialogue with a state such as the UK that shares a similar security culture.

*B Nordic Defence Cooperation (NORDEFECO) much cooperation less output*

Sweden, Denmark, Finland and Norway signed the Nordic Defence Cooperation (NORDEFECO) Memorandum of Understanding in 2009 in a bid to expand military and industrial cooperation in the region. The NORDEFECO MoU merges three cooperative frameworks previously in existence. *Nordac* (1994) was a framework to allow for closer cooperation on acquisition. *Nordcaps* (1997) was a framework within which Nordic and Scandinavian countries were organizing peace support education and training for joint military peace support. *Nordsup* (2008) launched an effort to identify around 140 areas where cooperation among Nordic and Scandinavian states is possible to retain defence capabilities.<sup>30</sup> However palpable output has not been seen so far.

*C From overlapping clusters of Nordic Cooperation into Nordic-Baltic defence pact?*

The Nordic countries already made positive experiences with pooling and sharing in the fields of common transports and common logistics.<sup>31</sup> Nordic cooperation has long-term objectives, including common weapons procurements and more commonality in military operations and equipment. Some key-cooperation projects include: the EU's Nordic Battlegroup; joint development of the Sea Surveillance Cooperation Baltic Sea project; and the feasibility of improving the Nordic defence industry's capability through common weapon programs. Through joint training and exercising, the declared intention of participant nations has been to create the platforms needed to support a higher level of cooperation.<sup>32</sup> In January 2010 an agreement among the air forces of Finland, Norway and Sweden was signed to increase the number of joint exercises in 2010 and strengthen the foundation for multinational fighter squadrons for regional air-policing duties. The agreement built on the Cross-Border Training Agreement from 2009, which promoted two-nation exercises. Sweden has also proposed putting helicopters or other military assets at the disposal of Danish, Norwegian, or Finnish crews for international missions.<sup>33</sup>

The Nordic Defence cooperation effort is not designed to remain a closed shop, as cooperation talks have already been extended to the Baltic States and mutual interest in expanding cooperation with the UK, Germany and Poland has become evident.<sup>34</sup>

A proposal to set up a shared surveillance effort over the North Sea is seen as attracting broad Nordic support.<sup>35</sup> Finland is hesitating over a proposal backed by Denmark, Norway and Sweden to conduct fighter jet patrols over NATO-aligned Iceland. It cites its own neutrality as well as the sizable commitment of planes and money as obstacle for a commitment.<sup>36</sup>

Finland decided to work more closely with Estonia on its € 750 million National Air Defence Modernisation Plan (NADMP) until its scheduled completion in 2015. Finland's traditional support of defence system development within the Baltic States is largely concentrated on Estonia, with more modest support to the defences of Latvia and Lithuania.<sup>37</sup> Estonia is keen on identifying value-added, pragmatically implementable solutions for pooling and sharing.

On 15<sup>th</sup> December 2010, Estonia and the UK concluded a framework agreement on joint acquisition of defence equipment, opening the road for information-sharing on defence, arms or munitions

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<sup>30</sup> Nordic Cooperation—History and Background, [www.nordefco.org](http://www.nordefco.org), 23.03.2011.

<sup>31</sup> Gerard O'Dwyer, 'Nordic Countries to Pledge Common Defense', *Defense News*, 22.11.2010.

<sup>32</sup> Gerard O'Dwyer, 'Five Nordic nations boost air-defense cooperation', *Defense News*, 15.02.2010.

<sup>33</sup> Gerard O'Dwyer, 'Nordic Meeting Shows Progress – and Limits – of Defence Cooperation', *Defense News*, 18.05.2009.

<sup>34</sup> Gerard O'Dwyer, 'Nordic Countries to Pledge Common Defense', *Defense News*, 22.11.2010.

<sup>35</sup> Ibid.

<sup>36</sup> Ibid.

<sup>37</sup> Gerard O'Dwyer, 'Finland, Estonia join forces on defense modernization', *Defense News*, 05.10.2009.



acquisitions planned or contemplated. Estonia signed similar agreements with Sweden and Germany.<sup>38</sup> Lithuania has stepped up its consultations with its Baltic neighbours and Poland in an effort to harmonize procurement processes to pool resources for joint procurements in order to economize and drive down operating costs.

#### *D Closer Defence Cooperation in the Realm of the South Eastern Europe Defence Ministerial Meeting?*

Pooling and sharing are issues currently being debated in Bulgaria, yet the time is not yet politically ripe to implement significant cooperation project. Improving the political relations to Bulgaria's neighbours in the Balkan/ South-eastern Europe is considered an absolute priority. The aim is to become an essential ally, if not a military lead-nation in the region.

During the Bulgarian chairmanship of the first meeting of the South-Eastern Europe Defence Ministerial (SEDM) Process (2009-2011)<sup>39</sup> in October 2009, the Bulgarian Defence Minister Mladenov identified the financial crisis and economic stagnation as factors that should be taken into account upon formulating the future forms of cooperation, to "invest not only in national but also in joint efforts to achieve higher efficiency."<sup>40</sup> Mladenov stressed the need to fully utilize the potential of the South Eastern Europe Brigade (SEEBRIG), and to analyze which type of missions the Brigade should fulfil in the future.<sup>41</sup> Cooperation talks have also been taking place with Serbia and Romania. With Serbia, Bulgaria is discussing military exchanges, joint military exercises and industrial cooperation as part of a military *rapprochement*.<sup>42</sup>

With Romania, Bulgaria is considering closer cooperation in the area of maintenance, crew training and air policing, given that both countries will equip themselves with the same multi-role aircraft.<sup>43</sup> Concluding the reforms of the armed forces is considered a priority and concrete pooling and sharing may then resurface on the political agenda after 2014. Accordingly, the Ghent-Process is being acknowledged in Bulgaria but does not come center-stage in domestic debates. Bulgaria to date prefers to concentrate on bilateral relations to the US, which still invests substantial amounts into the Bulgarian armed forces.

Greece is currently considering options for pooling and sharing redundant capabilities at EU level. Decisions are to be expected in the first half of 2011. Beyond the creation of the Franco-Italian Brigade in Spring 2010 and the hope to strengthen national defence industry through European armaments cooperation, Rome has not yet signaled particular interest in furthering European cooperation out of financial motivations. Slovenia engages in closer defence cooperation with Serbia, Croatia, Macedonia and Austria yet cooperation does not go as far as pooling and sharing.

#### *E Closer Defence Cooperation Among the Visegrad Four?*

Although discussions still stand at the outset, pooling and sharing are options currently being discussed with much intensity in the Czech Republic. Especially closer cooperation with the Visegrad Four (Poland, Czech Republic, Slovakia, Hungary) is considered to be an interesting option. However, doubts remain with regard to an equitable burden-sharing among the four. Cooperation with Slovakia seems here most likely and promising, since the armed forces of both states already closely work together. On the background of the debate about prolonging the leasing of Gripen-fighter jets, Prime Minister Necase

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<sup>38</sup> *European Diplomacy and Defense* No.377, 21.12.2010, p.2.

<sup>39</sup> Participants to the SEDM are Bosnia and Herzegovina, Bulgaria, Greece, Italy, Macedonia, Romania, Slovenia, Turkey and Ukraine. Observer Nations are Montenegro, Georgia, Moldova and Serbia.

<sup>40</sup> 'Southeast European defence ministers meet in Bulgaria', *BBC*, 21.10.2009.

<sup>41</sup> *Ibid.*; 'Bulgaria hosts southeast Europe defence meeting on security, cooperation', *BBC*, 14.09.2010.

<sup>42</sup> 'Bulgarian, Serbian defence ministers discuss joint exercises, cooperation', *BBC*, 14.12.2010.

<sup>43</sup> 'Romanian, Bulgarian defence ministers discuss defence relations', *BBC*, 02.06.2010.

has been advocating for a while the sharing of planes with other NATO member countries, inspired by the example of the Netherlands and Belgium, which are building up a joint Navy.<sup>44</sup>

In late November 2010, the Hungarian Ministry of Defence expressed strong interest in cooperation with Slovakia to train Mi17-helicopter pilots. Hungarian pilots could train on a special flight simulator in Presov (Slovakia) while Slovak pilots may gain experience at the Hungarian air base in Szolnok. Cooperation between Slovakia and Hungary is already ongoing with regard to pyrotechnics and bomb disposal.<sup>45</sup> In May and June 2009 talks were also held on Hungarian-Greek and on Hungarian-Macedonian cooperation concerning military training.<sup>46</sup> A paper from late 2010 confirms the need for specialization of the Hungarian army including the development of niche capabilities such as NBC defence,<sup>47</sup> instead of maintaining the ambition of a full spectrum force. Cooperative divisions of labour with small nations, such as Austria, Slovakia, Finland or Belgium similarly affected by the crisis are listed as policy priority.<sup>48</sup> Hungary has put the furtherance of pooling and sharing as priority onto the agenda of its EU Presidency in 2011 and intends to strengthen the Ghent-Process.

#### *F The Weimar Triangle Political initiative with concrete objectives*

The Weimar initiative to CSDP by France, Germany and Poland aims to strengthen CSDP capabilities through increased multilateralization and pooling of forces in three precise areas: Battlegroups, capability short falls and command & control. Multilateral headquarters.<sup>49</sup> The initiative shows its distinct political spirit as it picks up upon the history of consultative meetings, aiming to support EU integration by leading EU member states from the East to the West of Europe.

The initiative has been Europeanized by the High Representative in January 2011 through its reply to the letter of the Weimar Triangle ministers of foreign affairs and of defence. It will be taken forward on the EU/EAD level.

On the issue of pooling and sharing, Warsaw has been engaged in a close dialog with Berlin and Paris as part of the Weimar Triangle since 2010. Poland, Germany and France sent a letter to the EU High Representative Lady Ashton in mid-December calling for the improvement of capacities to plan and to conduct operations and missions, to strengthen cooperation among their militaries and to create synergies in times of scarce resources, taking due care for complementarities with national and NATO planning capacities. Germany, France and Poland will enhance their cooperation within the Battlegroup, which they are to provide in the first half of 2013. Moreover Germany will provide the installations for a multilaterized EU Force Headquarters.

#### *G Franco-German Defence Cooperation –currently nothing in common?*

Building on the long standing bilateral defence council, Paris has engaged Germany on the issue of pooling capabilities over the past months through different structures: The Franco-German Ministerial Council, the Franco-German Defence and Security Council (with its working groups on capabilities, strategy and operations, and sub-working groups on different armed services and armaments policy) and finally the ad-hoc working group launched by both Defence Ministers in mid-2010 tasked to identify specific projects for further cooperation. However, the process has not delivered results so far.

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<sup>44</sup> 'Experts suggest Czechs save on fighter plane costs, cooperate with NATO allies', *BBC*, 02.07.2010.

<sup>45</sup> 'Hungarian army interested in Slovak flight simulator, more cooperation', *BBC*, 01.12.2010.

<sup>46</sup> 'Hungary, Greece army chiefs discuss military cooperation', *MTI-EcoNews*, 18.06.2009. 'Macedonia, Hungary sign military cooperation agreement', *Xinhua News Agency*, 07.05.2009.

<sup>47</sup> Bastian Giegerich, *European Military Capabilities*, IISS, 2008, p. 50.

<sup>48</sup> Nicolas Gros-Verheyde, Sous la contrainte budgétaire, l'armée hongroise réfléchit à son avenir, <http://www.bruxelles2.eu/defense-ue/armees-europeennes/larmee-hong>, 09.01.2011.

<sup>49</sup> Gabriela Baczyńska, 'France, Germany, Poland urge closer EU defence ties', *Reuters News*, 13.12.2010; . Claudia Major: A Civil-Military Headquarters for the EU. The Weimar Triangle Initiative Fuels the Current Debate. SWP Comments 2010/C 31, December 2010.



## *H      The Ghent Process – towards a European Strategic defence review?*

In early December 2010, Germany and Sweden confirmed they would seek to start a process in which EU member states sought to undertake more joint responsibility for military matters.<sup>50</sup> Both states are at the origin of the *Ghent Initiative*, which aims to assess options for pooling and sharing. The initiative has been welcomed by the European Council in December 2010 and is thus 'Europeanized'. During the next six months CSDP member states will analyze their national capabilities along three criteria: (1) as to what extent and by what measures the interoperability of those capabilities that have to remain under national control could be increased; (2) which capabilities allow options for pooling; (3) which capabilities and support structure offer potentials for role specialization and task-sharing through intensified cooperation.<sup>51</sup> In the first half of 2011 the results of the analysis will be presented to the High Representative Lady Ashton.

## **4      TOWARDS AN EFFECTIVE EU DEFENCE SECTOR STRATEGY IN TIMES OF AUSTERITY**

The financial crisis has put the public budgets throughout the European Union under severe pressure. After massive debt-financed recovery programmes the states now seek fiscal consolidation by reducing all public spending in a long-term perspective. The times of austerity may last for up to two decades, depending i.a. on the fiscal discipline member states show in the consolidation of public spending. Consequently, the consolidation process will have to aim beyond short-term cuts to seek structural spending reforms designed to have an effect in the medium term.

The impact of the budget crisis on the defence sector is to some extent until today a matter of political priorities. However, especially for the small and medium sized countries, it has become costly reality which they cannot escape. But it is obviously only a matter of time until the increasing pressure of public debt services may include the defence sector into those areas that have to contribute to fiscal consolidation. It is questionable whether the required savings can be achieved by simply cutting down the existing national structures and forces.<sup>52</sup> The current revitalisation of existing cooperation frames as well as the new initiatives, especially the Ghent initiative, can be interpreted as signs that this has been understood by EU member states.

While some observers consider the situation as a chance to deepen EU-Integration in the military realm, current activities of member states still point in the opposite direction. States tend to plan and implement their cuts at the national level, without much coordination or even communication at the EU level about who is cutting what. The national reflex remains strong and creates the risk of a growing capability gap if member states continue to diminish capabilities in an uncoordinated manner. Uncoordinated savings will most likely also impact with some delay on the European technological and defence industrial base.

### **4.1      A European Imperative - The why and how of future EU Capability development**

Why should Europe keep on trying to enhance its military actorness? The EU's current political state may well limit the appetite for more initiatives towards cooperation. However, three arguments clarify that an EU as a capable military actor is more a question of necessary responsibility of the governments vis-à-vis their populations rather than a question of choice and taste.

First, the US will in future be less available for EU requests for help. The United States have for a long time not only backed but considerably enabled Europe. But the US will be increasingly bound in Asia. It

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<sup>50</sup> Dave Graham, 'Germany plans to boost military cooperation', *Reuters News*, 09.12.2010.

<sup>51</sup> Council conclusions on Military Capability Development. 3055th Foreign Affairs (Defence) Council meeting Brussels, 9 December 2010. [http://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/esdp/118348.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/esdp/118348.pdf)

<sup>52</sup> Christian Mölling, Sophie-Charlotte Brune, and Marcel Dickow, *Finanzkrise und Verteidigungskooperation. Materialien zu acht europäischen Ländern und den USA*, Berlin, Stiftung Wissenschaft und Politik, 2010. (SWP-Arbeitspapier, FG3 AP4, October 2010)

has already made clear that it does not any longer perceive a more integrated EU-defence posture as a threat to NATO. Instead it acknowledges the positive effects such an EU pillar could have for NATO. Hence the EU will have to take over more responsibility in international crisis management. However, the individual states are less and less able to shape security unilaterally. This is a strong argument for cooperation. Besides a strategic reorientation driven by changing risk perceptions, even the US will have to manage their defence posture with less budgets. Defence minister Gates made clear that the current level of over sea presence on the European continent may need to be reduced.

A second argument for more cooperation is sovereignty. Currently sovereignty is the core issue that hinders deeper cooperation. However sovereignty, understood as capacity to act, is also the biggest argument for cooperation: How capable are the individual member states? What are Germany, Italy, Sweden or even France and the UK able to achieve individually in the military realm? And what is necessary in the light of real world risks and responsibilities in EU and NATO? As the answer increasingly tends to be negative, cooperation is the only way EU-states can keep or regain the sovereignty they already lost during the last years. The effects of the financial crisis reinforce this tendency. Other elements, as the demographic development, suggest that this trend will not change in the foreseeable future. Sovereignty hence means having the capacity to act, and this capacity depends to a great extent on collective efforts and intensified cooperation at the EU level.

Third, future crises will be more civilian but not always non-violent. The EU offers the necessary comprehensive toolbox to engage with these future types of conflict. While preventive structural policies have to play a major role, the option to resort to military force as part of a political strategy cannot be ruled out.

#### **4.2 A comprehensive political approach: Elements of a defence sector strategy**

Europe needs a defence sector strategy as comprehensive answer to its major problems. Using the current situation as a turning point for more effective and efficient EU capability generation Europe needs a defence sector strategy as comprehensive answer to its major problems outlined above: The conceptual, institutional and material linkage between armaments phase and the capability development phase as well as increased performance in each phase.

To ensure that CSDP gets reenergized, the challenge is to combine the following ingredients into an approach that goes beyond the current incremental one:

- opportunities offered by Lisbon Treaty, EDA and Commission
- the necessities of the economic crisis, especially by adapting the capability generation framework to the realities of austerity
- initiatives by the various EU countries as well as lessons learned from existing cooperation the less and the into an effective defence sector strategy

Europe's problems and challenges are interlinked among the areas of capability development and armaments. Hence, the solution has to reflect this interaction. This implies also to tackle the different dimensions: security, technology, economy and the industry-related one.

Moreover, the EU has to manage the interacting challenges posed by the financial crisis and the characteristics of its capability generation framework. Especially the institutions and provisions that could increase coherence among the capability generation phases exist already: the provisions of the Lisbon Treaty and the EDA. Both offer institutional answers to the challenges among as well as within the two capability generation phases. Here, the challenge is their implementation. Conceptually, capability development and armaments must be adapted to crisis-induced new realities. It would mean to give priority to the security function of armed forces, to balance it against necessary technological and industrial functions. Moreover domestic issues like jobs and local taxes would have to be subordinated. This implies to expand common concepts and objectives such as headline goals from the

military to the industrial and technological domains. This has to be followed by an effective link of existing resource pools to these concepts and mechanisms.

Hence this paper proposes a more comprehensive approach to the defence sector. Tackling the problems would comprise solutions for Elements of a defence sector strategy – overcoming the currently isolated approach to the various problems. These recommendations concentrate on the shape of an effective EU defence sector strategy in times of austerity (linking especially the industrial and capability dimension), the necessary steps to introduce and implement it in practice and the options of the European Parliament to support and push the member states for such a coherent and comprehensive approach.

### **4.3 Conceptual Link: An EU Strategic Defence and Security Review**

A dialogue is needed across islands of cooperation just identified with a view to guarantee that ongoing reforms are engaged in a way that is not harmful to the CSDP in the long run. A European-level SDSR would be a first step to review how member states efforts to meet the demands imposed on them by the financial crisis and the effect of cuts in military expenditures will influence their capabilities within the EU and NATO. Further, it would allow identifying capability improvements specific to each nation and facilitating setting a target for their cooperative or collective use.

In light of the disparate picture of cooperative efforts emerging, a European-level Strategic Defence and Security Review (SDSR) would be a first step to review how planned national cuts will influence joint capabilities within the EU and NATO. An SDSR would eschew the definition of political principles usually found in White Papers to adopt a bottom-up approach intent on identifying what concrete options are on the table to make the most of existing military capabilities across the EU to achieve political goals EU member states defined in the European Security Strategy of 2003.

It would allow drawing up a profile of each member state's capability strengths and weakness in order to identify areas in which pooling and sharing would make particular sense. A European SDSR would also help identify for which countries it makes sense to maintain full-spectrum forces and those states for which it economically and politically makes sense to focus on role-specialisation, niche capabilities. States should thus take a coordinated approach to cuts where it is adequate and harmonize them in a way that they do not undermine their overall capability in a given domain.

An important guideline in this endeavour ought to be the European Council's efforts in reorienting capability development at European level, initiated in 2008 via the "Declaration on Strengthening Capabilities". The benchmark outlined in this document could serve as a guide for coordinating national reform efforts/ cuts as well as cooperative clusters.

Engaging in such an effort makes particular sense at the present moment, since a number of states are currently drawing up national Strategic Security and Defence Reviews and drafting White Papers to come out in the course of 2011. These states are Poland, Bulgaria, the Netherlands and the Czech Republic, whilst Slovenia and the UK finished their most recent Review in 2010.

A European SDSR would make particular sense as follow-up to the current Ghent-Process, in which an enhanced role as facilitator could accrue to the EDA.

Ideally, the coherent and systematic pooling of capabilities at the European level would require a shared model of capabilities, including the possibility of having a European budget planning process for joint capabilities. In light of lacking wide-scale political backing to date for such a degree of European integration, intergovernmental models involving increased sharing and pooling of capabilities as well as some moderate form of role specialisation are more likely to succeed for the time being.

Of course they do imply a new understanding of sovereignty based on the insight that the ability of 27 small armies to deploy will never equal the ability and weight of a coordinated European approach. Such approach also entails greater creativity in working out solutions to guarantee access to capabilities

and interoperability in use and logistics. To that end, enhancing cooperation in low-key areas such as maintenance, training and education may offer a feasible start to level the way for more in-depth cooperation in capabilities.

Beyond this effort to pave the way for long-run integration, more concrete cooperative options are on the table already now. Looking into concrete cases where sharing and pooling could help foster joint capabilities at European level is a promising endeavour to provide some food for thought on options to bring about much needed savings and, in particular, more rationality and value for money in the € 200 bn. business of European defence. Examples may be found in the following sections.

#### **4.4 Institutional link**

##### **Using the full potential of the European Defence Agency**

First, the member states should entrust EDA as a driver and framework for developing pooling and sharing projects. The Agency can serve as a forum in which the member states develop a common understanding of multinational projects as complement to the national ones. This would be the pre-condition for Pooling and Sharing initiatives in various areas, such as equipment or logistics. Member states can build on the current EDA initiatives on the area established last year. Through this, EDA has once more demonstrated its timely engagement and utility to member states needs.

Second, the EDA should serve as central certification authority for military capabilities, particularly the Battlegroups. It would rebut criticism about lacking quality and deployability while also assuring constant quality and allowing for reliable planning.

Third, in view of the expected civil-military scenarios in crisis management, the member states should consider opening the agency for civilian aspects in view of creating civil-military synergies. In such a perspective, the EDA could for example support the development of joint civil-military transport arrangements. The same applies to future initiatives for pooling and sharing.

Finally, to integrate the economic dimension and to give a new *élan* to the original purpose of the agency, namely to allow member states to get more “bang for a euro”, finance ministers should play a stronger role in the EDA. This would be especially important as defence ministries tend to think much more in national terms and are sometimes less aware of the price tag attached to one or the other solution. Ministers of finance may participate in joint sessions at EDA with their MoD colleagues. They could also meet as a defence budget group. Such a group would be timely, given the upcoming defence budgetary challenges. The decision to set up such a group should be taken by heads of state and government, underlining that defence is a whole of government issue.

##### **Establishing Permanent Structured Cooperation through successful P&S practice**

For the moment, EU member states should stop theological debates on PSCoOp. Instead they should engage in concrete pooling initiatives that could become militarily effective, financially attractive and sustainable solutions. PSCoOp should be seen as a self-establishing principle if pooling initiatives are successful for a longer time. Questions similar to those in PSCoOp may surface but with a concrete point of reference, enabling debates related to empirical substance. To ease the kick off of such a bottom up PSCoOp, it can be based on existing projects and co-operation, especially in those areas with serious capability shortfalls. One first step could be to intensify the coordinated use of existing national capabilities (pooling). The option of making the Eurofighter the heart of an autonomous European air policing capability under PSCoOp should be weighed up. A very suitable example at hand could be the European Air Transport Fleet (EATF). PSCoOp would here mean a more coordinated use of already existing or planned national capabilities. The EATF states would share the operation and maintenance of the airplanes and the training of crews. A leading and coordinating role could be played by the European Air Transport Command. This would draw on existing equipment. Demand for pooling also exists in the area of unmanned aircraft (UAVs) and transport helicopters.

However, in the longer run it will become essential to consider very much further-reaching European cooperation models, also in order to cut national costs. PS Coop should offer those EU member states that already contribute to defence efforts at a relatively high level tools for working even more closely together to expand their military capabilities. Hence, beyond such a bottom up approach to PS Coop, those member states willing and able to advance quicker and effectively in the development of capabilities, should engage in debates on how to use PS Coop as an enabling tool for them.

## **4.5 Linking Resources**

### **Pooling R&T Funds**

As the most flexible expenses, investments in Research and Technology (R&T) are imminently threatened by cuts across the EU. First announcements of these have already been made by Italy, Spain and France. In order to limit the impact of defence investment cuts on the overall defence capabilities of the EU, pooling R&T funds seem to offer the best solution.

The reason why more money should not be put into one pot for R&T in areas that are equally relevant for most European major military powers remains scant. Priority areas are on the one hand satellite communications, unmanned systems, naval systems and complex weapons. R&T in these areas is time critical. On the other hand sensors, electronic warfare technologies and materials, as well as simulation may be considered, as they represent areas of critical industrial importance.

### **Joint Investment and Procurement**

Besides pooling R&T funds, common investment and procurement programmes are an option to consolidate demand. Existing programmes, e.g. the A400M or the Eurofighter, can be assessed only as a limited success. Although they deliver the equipment needed, they also show a magnitude of organizational and technical problems, stemming from the political, not economic, character of the primary impulse for cooperation. Thus, the willingness of the EU states to establish new joint programmes, particularly ambitious ones, is currently reduced.

Yet, international armaments cooperation is not inherently more complicated than national armaments development. It does, however, exponentially augment political and co-ordinatory challenges already present at national levels. Close attention is required, first, to the harmonization of requirements and their controlling so that they do not spiral out of hand; second, to the shared use of jointly procured capabilities, to avoid duplication. Finally, in Joint R&T projects, favouring step-by-step development geared to 80% rather than 120%-solutions is bound to contribute to the reduction of the well-known pitfalls of defence procurement both at national and international levels. Where it turns out to be adequate, procurement ought to rely to a greater extent on Commercial and Military Off the Shelf solutions (COTS-MOTS) as well as outsourcing through Public-Private Partnerships (PPP) or private providers.

### **Linking EU and EDA budgets for R&T 53**

The Lisbon Treaty has opened up new ways to finance and conduct defence R&T activities and to redefine the status and competences of the EDA. Article 179.1 TFEU, by changing the scope of European research policy, links defence research to the EU's general research policy. This increases the pressure to find a common organisational framework for it. At the same time, Article 45.2 TEU gives governments the rare opportunity to redefine the role and position of the EDA vis-à-vis the other EU institutions: "The Council, acting by a qualified majority, shall adopt a decision defining the Agency's statute, seat and operational rules."<sup>54</sup>

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<sup>53</sup> Mölling/ Teichler Forthcoming SWP-Comment 2011

<sup>54</sup> TEU Ibid. "Consolidated version of the Treaty on European Union." 13-45.



The negotiations about the Financial Perspective – the EU's multiannual budget for the years from 2013 to 2020 – will determine whether defence R&T might be included in the EU budget as a separate item or not. If defence R&T were not to be included in the EU budget, then it would continue to be financed exclusively by national budgets, a decision that cannot be amended for the duration of the Financial Perspective. As a consequence the potential closer and innovative cooperation between military and civil R&T and a more efficient use of scarce defence R&T funds for CSFP capability development would be foreclosed. For another decade, defence R&T cooperation in Europe would remain under the exclusive control of MoD while the stronger dynamics in civil research area would be left unexploited.

Three Options for future financing and organizing European defence R&T exist: If defence R&T is included in the Financial Perspective, research activities required for the CSDP could be financed, at least in part, through the EU budget.<sup>55</sup> Cooperation at EU level could take three forms, varying as to who would oversee the formulation of research policy and who would manage the use of defence research funds:

### **Defence research as part of FP8 overseen by the Commission**

Defence research could be integrated to the largest possible extent with the EU's existing research instruments. In analogy to FP7 (2007-2013), which included for the first time security research, the next FP could entail defence research as a new domain. The Commission drawing on advice from governments and industry would plan, oversee and manage its funding.

While such a solution could generate a maximum of synergies with other civilian research themes, there are considerable risks and disadvantages. The general orientation of the FP on basic research and its rules, designed to promote openness towards the world and sharing of research results, are ill-suited for defence research, which is capability driven and where secrecy can be essential for security reasons.

The political leadership would stay with the Commission, delegating the implementation to the EDA via a contribution of "earmarked revenue" to the Agency's general budget. This could neither be in the interests of governments, parliaments, of MoDs or of the EDA. Moreover, given that this type of revenue cannot be spent on personnel and that an increase in the EDA's annual budget would depend on unanimity in the Council, a considerable number of the 120 employees would need to be shifted to deal with research with negative effects on the work of the other Directorates.

### **Defence research overseen by an enhanced EDA**

Alternatively, the EDA could be given a new statute and operational rules. Article 45 TEU provides the legal basis for such a move and requires only a qualified majority in the Council. The EDA would receive financial resources not through the Commission but as a separate budget line from the EU and could implement it independently.

In this way, the EDA would be institutionally strengthened within the entire EU machinery, with governments maintaining political oversight over defence research. In the long run this would have the surest and largest benefits for the development and procurement of defence capabilities. Cooperation between the Commission and the EDA in order to achieve synergies would be more balanced. However, significant political resistance can be expected from countries who have in the past openly opposed an increased role of the EDA in defence research such as the UK or the Netherlands.

This way would, nevertheless, allow achieving a maximum of savings through European cooperation. If a significant part of defence research became to be managed at EU level, national management capacities in the 26 participating MS could be reduced. While this might be advisable in times of tightened defence budgets it remains doubtful that defence administrations would be enchanted by

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<sup>55</sup> While research for nuclear weapons or encryption would remain national responsibility, research on CSDP capabilities such as CBRN, intelligence, surveillance, target acquisition and reconnaissance architecture or medical support could benefit from EU funding. For a list of relevant areas see EDA. (2008). "Background Note on Capability Development Plan." from <http://www.eda.europa.eu/genericitem.aspx?id=386>.

this prospect. After all, the R&T Steering Board of the EDA is composed of national R&T directors whose internal position and influence is often considered proportional to the size of staff working for them.

### **Flexible cooperation by interested member states in dedicated project organisations**

A third way for closer integration of defence R&T at EU level might therefore be more promising. While R&T would be included in the EU budget, management and implementation would proceed through a mechanism provided by Article 185 TFEU. It concerns not only research but also development programmes i.e. a scope that would be suitable for defence purposes with its focus on capability development. The article states that the Union “may make provisions” to programmes “undertaken by several Member States”.

This option implies on the one hand, that a defence research programme would need to exist among MS. Only then the Commission could contribute to it. Given that there would not be any right of initiative for the Commission, MoDs would remain in control of the defence research. On the other hand, the flexibility provided by Article 185 would allow for an opt out by some governments. They would only participate through the EU budget in these projects, which would enable the EDA to draw on firms from those countries.

Finally, Article 185 implies that an implementing structure has to be created for such programmes. Thus, the EDA won't need to employ additional personnel and could continue to operate on its existing (or a slightly altered) legal basis. The potential for mid- to long-term cost savings would be considerably smaller than in the second way as national defence research administration would be required for an active support of the “implementing structures” of each project.

## **4.6 Tackling the capability development deficits**

### **Pooling & Sharing in logistics and beyond**

The EU member states should make more use of pooling and sharing (P&S), and actively engage in joint initiatives, be it in the area of capabilities, logistics or equipment. P&S allows to reduce costs and to ensure a better reliability of the required good. A number of concrete cooperative steps for pooling and sharing are already on the table. These would make particular sense in light of current strategic shortages and equipment needed in ongoing deployments.

#### **Logistics**

One example is logistics. With the help of framework agreements, the EU should pool the logistics of EU operations. This would require all member states to agree on basic standards, such as for life support, in order to create transparent requirements for the (civilian) contractors. It would simplify tenders, facilitate the quality check and allow concluding enforceable contracts. As mentioned above, the EDA could play a key role here, building on its TPLS platform and related experiences. Additionally, the member states could pool their resources in logistical warehouses.

### **The European Air Transport Fleet and the A400M**

Important items for P&S are identified by the European Air Transport Fleet (ETAF) Declaration of Intent (10. Nov. 2008), which states that the participation of EU Member States to the EATF in order to improve airlift capabilities in the EU could take the form of making available military transport aircraft; purchasing, providing or exchanging flying hours; and to provide and benefit from shared or pooled support functions.

An option for enhanced savings could be for the other nations participating to EATF that also ordered A400Ms (Germany, Spain, Belgium and Luxemburg) to pool their planes and join London and Paris in their cooperative efforts for training and logistics. This initiative could represent a budding European A400M-fleet for strategic airlift. The 2008 initiated European Air Transport Fleet (EATF) will pool



European air transport capacities once it will be operational in 2014. Comparable models should be envisaged for sea and land transport.

### **A European Air Defence Fleet and Launching Baltic Surveillance**

Eurofighter nations and others could pool a certain part of their aircraft to form an EADF. This would represent another option to jointly save on maintenance and logistics. At the same time, such pooling could favour joint training and become the basis of a division of labour among states to guarantee missions other states cannot cover in the EU. Air Policing over the Baltic States has proven the feasibility of such co-operation. Moreover, creating a *Baltic Naval and Air Surveillance*, involving the Baltic States, Finland, Sweden, Denmark, Germany, and Poland could successfully feed from existing capabilities (Eurofighters, Gripen, F18s and F16s) as well as from already proven operational co-operation between Finland and Sweden. It would extend the co-operative experience of NATO's German-Polish-Danish Corps into the maritime dimension.

### **Maritime Mine Countermeasures**

The overall aim of the European Defence Agency's (EDA) Maritime Mine Countermeasure (MMCM) Category B Project, is to prepare the replacement of the current capabilities of 11 EDA participating Member States from 2018 onwards.<sup>56</sup> France here acts as lead nation. Germany has historically showcased a great proficiency in mine-sweeping and certainly would contribute in a meaningful way to closer cooperation with London and Paris on this front and potentially contribute to a stronger start-up core.

### **UAVs and Communications Satellites**

The planned assessment in 2011 of the prospects for a joint MALE UAV programme to be developed between 2015 and 2020 – another UK-French project – holds promise for cooperation to enable potential sharing of development, support and training costs, and to ensure that French and British Forces can work together. Whilst details remain scant on this point, France and the UK further want to assess cooperation potential for communications satellites. Yet in the 2020-2030 timeframe, such capabilities are also a matter of general European concern, in particular improved SATCOM capacities will be absolutely essential for UAV operations.

Furthermore, the strategic concern of both countries does not emphasise the potential civilian uses of UAV capabilities for homeland security uses (maritime surveillance, border surveillance) in which a greater number of European partners may be interested. Wider participation in acquiring Off-the-Shelf solutions may yield lower costs. Again, procuring jointly UAV capabilities and pooling them may fill a strategic need with dual utility both in the military and civilian field. From an Industrial perspective, a further option for European cooperation beyond the Franco-British interest in MALE UAVs might be to develop lower altitude medium endurance UAV technologies.

### **Use ATHENA to support the acquisition of shared EU equipment for joint operations**

The lack of adequate options for financing joint capabilities or their availability limits the EU's ability to take action. In the military realm, only the costs related to Headquarters are covered regularly by all CSDP member states. This happens through a special mechanism called Athena. Athena finances the purchase of new equipment for each individual operation. These costs could be reduced if the EU member states would purchase their materials jointly and make them available for shared operations. This would make the EU less dependent on the individual member states that have provided equipment up to now. The equipment could be stored at a central location, where strategic transport would also be based. Hence Athena should be moderately expanded to include the joint EU purchase of military equipment that is used on every operation, such as HQ infrastructure and accommodations.

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<sup>56</sup> Participant states are Belgium, Estonia, Finland, France, Germany, Netherlands, Poland, Portugal, Romania, Spain and Sweden (+ Norway as contributing Member State).

## Using EU Battlegroups as a laboratory for Pooling & Sharing

The EU Battlegroups are currently the best developed mechanisms for regular and intense military pooling and sharing at the EU level. However, they disband after 6 months leaving out the option of economies through established routines. Moreover, they are too small to provide for the bandwidth of capabilities needed for current days contingencies. EU-Battlegroups should be used as starting point and a pool of best practices for an incremental evolution of P&S. This could take the form of continuation and extension. Some progress into these directions will be made possible as part of the Weimar triangle.

**Continuation:** more continuity could be reached if a group of member states decided to take over the responsibility to man a Battlegroup on a permanent basis. Currently, BG change according to a six month rotation scheme. Starting point for such a long-term cooperation could be the existing regular co-operation between individual countries for instance in the context of the Nordic Battlegroup. Apart from the political symbolism, continuation would also bear military and economic advantages: Logistics, command and control and planning arrangements could be used continuously. The institutional knowledge on the command level of a unit would be continuously available. This solution could contribute to the further harmonization of standards.

**Expansion:** The BG-concept could be expanded to include more troops and to comprise a more comprehensive mix of capabilities. The aim would be to transfer the high degree of readiness that is linked to a Battlegroup to a larger part of EU armed forces. Instead of the ten-day readiness anchored in the original BG Concept, a gradual approach to readiness could be introduced. Such a larger formation would comprise troop units that exhibit various degrees of readiness, from 48 hours to 60 days. Every time a part of the larger unit is deployed, another troop unit with the same ability, but lower degree of readiness follows. Thus the overall troop component remains on the highest possible level.

### Personnel: More effective military structures

Substantial potential for savings can be found in the largest budget item: personnel. As already mentioned, the twenty-six states participating in the CSDP still foot the bill for nearly two million soldiers, a number with no basis in the needs of current or future crisis management operations. Therefore structural reform can produce savings without harm to operational readiness, modernisation or procurement. However, fundamental interventions will require national military planning of the different countries to be coordinated, and ideally overcome.

The EU battle groups represent a first, small step in this direction. As well as creating a quick response capacity for the EU, they have also already positively influenced communication between the respective troop contributors with regard to joint operations concepts, training and equipment. The underlying mechanism for generating European capabilities should be expanded to other fields. A modular structure and complementary scheduling of national contributions would represent a big step for the EU towards joint operational readiness.

Another option is role specialisation, with individual states limiting themselves to particular military capacities which they then coordinate with partners such that in alliance all required capabilities are available. That naturally means a greater degree of mutual interdependence. But this can be reduced – and a degree of redundancy introduced – if critical capabilities are provided by a small group of states rather than just one.

## 4.7 Engaging with the armaments dimension

### Towards a European Industrial Policy

If there is to be comprehensive reform of the EU's defence technological and industrial base it would be obvious to develop a European industrial policy aligned with PSCoP to organise and implement a

consensus about a sensible distribution of national core competences for the benefit of the Union as a whole. The precondition for this would be to define strategic priorities for the joint capability portfolio the EU wishes to maintain and promote. Special attention should be given to those technologies that ensure certain independence over other actors or where there are already comparative advantages within the EU.

Hopes are high that the European Commission's "Defence Package" may bring about – through enhanced competition – a further consolidation of supply. Yet, whilst firms are already re-orienting with greater consequence towards global demand, industry representatives are quick to point out that a meaningful consolidation of demand also needs to take place. The latter may well entail a risk – seen from a national point of view – of a redistribution of production lines and the weakening of technology bases in European countries.

Despite calls for sustained targeted national orders, industry is keen on enhancing its exports. Since the reliance on export-led growth emerges as the main reaction of most European defence firms to the crisis, the issue of the sustainability of such strategy will sooner or later emerge. Two dynamics are likely to surface:

First, European firms risk being crowded out of sectors where there is too much European and international competition, driving down income and eventually leading to externally induced consolidation of supply. Especially Small and Medium Enterprises will be concerned by this trend and are likely to be less resilient in case firms rely to a greater extent on technology transfer to increase export shares.

Second, over-supply may increase the bargaining position of those states currently purchasing defence goods. Increased transfer of Intellectual Property Rights (IPR) might be the difference that makes or breaks a deal. If European firms are over-reliant on export strategies, especially towards rising powers, important IPR may be lost—with ensuing political, strategic and economic consequences. Joint European export support strategies could be one remedy to the problems likely to arise in the face of an uncoordinated rush to greater export reliance.

### **Towards an Industrial Headline Goal 2030**

Back in 2006 the defence ministers of the EU member states subscribing to the ESDP (i.e. all but Denmark) declared that: "... a fully adequate DTIB is no longer sustainable on a strictly national basis – and that we must therefore press on with developing a truly European DTIB, as something more than a sum of its national parts. We cannot continue routinely to determine our equipment requirements on separate national bases, develop them through separate national R&D efforts, and realise them through separate national procurements. This approach is no longer economically sustainable – and in a world of multinational operations it is operationally unacceptable, too."<sup>57</sup>

Member States also need to find common denominators in their approach to armaments policy in order to define a strategic European defence-industrial policy. Such policy would contribute to the consolidation of defence industry across the EU by strengthening those sectors, in which Europe's defence industries hold a comparative advantage on the global market. Candidates to such strategic European industrial policy could be the aerospace (aircraft, UAV, satellites), missile, naval (including submarines) and protected-vehicle sectors.

Defining industrial headline goals for 2030 could be one step to materialize such strategic European industrial policy. It would be based inter alia on the mapping of the European industrial comparative advantages by global comparison as well as on the objectives of appropriate technological sovereignty (where dependencies of the EU are not considered reasonable).

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<sup>57</sup> <http://www.eda.europa.eu/genericitem.aspx?area=30&id=211>

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Under the pressure of industry, London and Paris also tacitly seem to have agreed on trying to form a monopoly in the field of nuclear submarine technology. A clear division of labour along lines of production could be a useful outcome of this trend. In the naval sector, a consolidation at European level of French and German competencies in the field of conventional submarines could represent one option.

### **Consolidation of Demand**

Consolidation can happen either through joint R&T projects or through bundling demand for shared capability needs (harmonization of demand, synchronization of procurement, cooperative or common procurement).

It seems illusory that a stronger reliance on exports on behalf of industry can be – or even should be – avoided altogether. Yet, greater cooperation between government and industry could help diversify industry's strategic approach in the face of the challenges ahead.

Industry cannot be required to consolidate without the adequate political strategic direction and impetus. Indeed, consolidation of demand is a matter of defence policy as well and needs to occur along politically defined strategic lines, possibly based on a joint European Strategic Defence Review. European demand – with harmonized and controlled requirements – needs to be bundled with greater consequence, in order to generate according revenues and economies of scale at the European level.

### **Encouraging the security-defence diversification in European Industry**

In order to cushion the blow from increased competition due to stronger export strategies, firms that are not competitive or not part of competitive sectors should actively pursue portfolio diversification by increasing reliance on civil security or on dual use goods rather than solely on defence goods – this may represent the best preventive means to avoid uncoordinated dismantlement of industry and job-losses across the EU. Industry and government ought to consult to devise exit or diversification strategies to this end. Some degree of sector consolidation seems unavoidable, however.

## **4.8 Specific Recommendations to the European Parliament**

This section closes with our recommendations to the European Parliament, taking especially into account the new rights the EP holds in the area of CFSP/CSDP. These recommendations will concentrate on the EP's options to support the necessary steps to introduce and implement an effective EU defence sector strategy in times of austerity (linking especially the industrial and capability dimension) delineated above.

### **Article 36 TEU**

Article 36 TEU postulates the EP's right of information on CSFP and CSDP issues on behalf of the High Representative. It also postulates the right to address queries and make recommendations to the

Council and the High Representative and establishes that it shall hold a debate on the progresses achieved in implementing the CFSP twice a year.

Even if these rights of consultation do not offer an excessive leverage to the EP, they offer a way to stay in the information-loop, bring ideas into the policy-process, and raise public awareness of key issues through regular public debates. More concrete recommendations to the European Parliament under Article 36 TEU are:

- to get regularly informed by Lady Ashton on progress achieved in the Ghent Process and the enhanced role of EDA in this context;
- to use bi-annual debates to take the opportunity to raise public awareness of key-issues in progress of the Ghent Process, including the defence industrial dimension;
- to take the results of this study as a starting point to encourage member states conducting a public EU Strategic Defence and Security Review or alternatively to that the study as a basis and transfer it through other means into a monitoring of member states activities. This could be a longer term project of an web based public effort, that collects relevant information;
- To encourage member states to make better use of the capacities and the potential of the European Defence Agency. The EP may underline the role of the EDA and an EU-Institution by strengthening the inter-institutional relations among EDA and EP;
- to encourage the Polish government to put an expansion of the areas financed by the ATHENA mechanism on the agenda of the regular revision meeting under their presidency. It should include joint purchase of military equipment that is used on every operation, such as HQ infrastructure and accommodations;
- to get detailed information on the member states perspective on EU Battlegroups as a success and failure and their future perspective;
- To introduce the idea of a European industrial policy and an Industrial HG 2030 to other EP committees, opting for a concerted approach vis-à-vis the Commission and the Council;
- to work out concrete ways to enliven the clause that the “views of the EP are duly taken into consideration” related to the problems and solutions pointed out in this study.

## **Budgetary**

In case that defence R & T were to be included into the EU budget, the EP would acquire leverage to shape the European agenda in line with a European Industrial Headline Goal 2030 as part of its budgetary powers. The same would be true if at least parts of the EDA Budget would be sourced from the EU-Budget.

## **Legislation**

Relevant legislative acts would most likely result from a concerted approach of the SEDE and other EP-Committees responsible for the classical community policies. Such joint approaches could be very effective, taking into account the underdeveloped framework in the area of industry and market issues in security and defence.

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